

RON GALPERIN
CONTROLLER

April 11, 2014

Honorable Eric Garcetti, Mayor
Honorable Michael Feuer, City Attorney
Honorable Members of the Los Angeles City Council

Introduction

The arts in Los Angeles are vital to our economy and quality of life -- creating jobs, attracting visitors and enhancing the civic landscape. One of the ways the City of Los Angeles has sought to assert its place as the nation's creative capital is through the City's Department of Cultural Affairs and its "1% for Art" programs -- which require that 1% of the construction valuation for new municipal and private commercial developments be set aside "for the creation of art within the public realm."

L.A.'s 1988 and 1991 "1% for Art" ordinances have been catalysts for more than 1,000 murals, sculptures, monuments, memorials, fountains and other artistic creations that Angelenos and visitors to our City can experience in public buildings, parks, commercial developments -- and on our streets and sidewalks.

But just as the City can be a catalyst for the arts -- it is vital that City Hall be a responsible steward of the fees that pay for that art. Toward that end, the Controller's office conducted an audit of the 1% for the Arts programs to determine whether the funds invested in the programs have been spent effectively -- and as they were intended.

What we found is that more than \$10 million in development fees and related interest has accumulated and is languishing in the City's Arts Development Fee Trust Fund. In fact, since 2008, the City has collected an average of \$1.3 million annually in developer fees -- along with accumulated interest earnings. But it has spent just \$654,000 of the Trust Fund's dollars on the arts over that entire period, and the City has had no clear plan for spending most of the money.

The City's residents, businesses and artists deserve better. To that end, our audit offers recommendations to fix the current state of inactivity -- and the Controller's office has collaborated with the City Attorney's office to lay the foundation for new policies that can offer greater transparency and more effectiveness, flexibility and accountability in the collection and use of arts development program fees.

Findings

The City's "1% for Art" programs are essentially three-in-one:

1. The Private Arts Development Fee Program (ADF) requires private owners and/or developers of non-residential developments to either:
 - a) Pay an arts fee equal to 1% of a project's construction valuation or a set per-square-foot rate, whichever is less. (The rate is supposed to be set according to the Consumer Price Index.) These "Developer Paid-In" monies are deposited into the Arts Development Fee Trust Fund (L.A. City Fund No. 516) -- which is designed to be used by the Department of Cultural Affairs to acquire and to create adjacent art and art projects; or
 - b) Design and construct an artistic or cultural amenity associated with the commercial development at a cost greater than or equal to the arts fee. These "Developer-Led" projects are acquired and installed by the owner/developer.
2. The Public Works Improvement Art Program (PWIAP) requires that 1% of the valuation of any municipal capital improvement project be set aside for an art component.

Since December 2006, the City has collected an average of \$1.3 million annually from developers for paid-in projects, and has set aside an average of \$1.7 million for PWIAP projects. Over that period, the City has also required developers to set aside an average of \$.7 million annually for developer-led projects. While each of the City's three 1%-related projects needs stronger oversight, our audit found that art projects generated with the more than \$1.3 million in Trust Fund deposits from developer paid-in projects have been at a virtual standstill.

Why hasn't this money been spent? To some degree, the Department of Cultural Affairs, which is charged with overseeing the 1% for Art programs, reported that it has been hamstrung by legal counsel that sharply restricted how the fees could be used. Based on language in the municipal code, the Office of the City Attorney advised in 2007 that private developer art fees must be used within a "one-block geographical radius" of the related construction project. No other California city reviewed by our auditors has such a strict policy.

After reviewing L.A.'s Municipal and Administrative Codes, the Office of the City Attorney is now seeking to work with stakeholders to untie the knot that has bound the 1% for Art programs-- and, we are informed, plans to develop updated guidelines. Simultaneously, we are urging the Department of Cultural Affairs to be more proactive and to become more responsible stewards of the public's money -- and its trust.

Recommendations

The Controller's audit makes several key recommendations:

- The Department of Cultural Affairs should solicit feedback from developers -- and from local stakeholders and arts community representatives to better improve assessment, collection and programming.
- The method used to calculate the ADF rate per square foot is supposed to be adjusted annually based on the Consumer Price Index, but has not been updated since the program's inception more than 22 years ago. The CPI has risen 58% in that time. Adjusting the fees could generate substantially more revenues for public art programs.



- For developer-led projects, the Department of Cultural Affairs requires either a letter of credit or a certificate of deposit, with the City as beneficiary, to essentially guarantee the developer's promise to incorporate 1% of a project's permit valuation as on-site art. This process, along with the forms used, needs to be evaluated and more consistently applied.
- The Dept. of Cultural Affairs should submit regular plans for the use of all PWIAP and ADF funds to the Cultural Affairs Commission, the Mayor and City Council for review and approval.
- An accounting system must be put in place to properly allocate interest earnings.

Conclusion

The findings of our audit underline the need to link the City's programming for the arts with the science of accounting and management. Only by doing so will the City be able to offer residents and developers a better return on their investment in public art programs.

"All great art is born of the metropolis," said the poet Ezra Pound. My hope and intention is that this audit can help more art – and more accountability – to be born from and for Los Angeles.

Sincerely,



RON | GALPERIN
Los Angeles City Controller





RON GALPERIN
CONTROLLER

April 11, 2014

Matthew Rudnick, Interim General Manager
Department of Cultural Affairs
201 N. Figueroa Street Suite 1400
Los Angeles, CA 90012

Dear Mr. Rudnick:

Enclosed is a report entitled "Audit of the Los Angeles Department of Cultural Affairs' 1% for Art Programs." A draft of this report was provided to your Department on August 30, 2013. Comments provided by your Department at the exit conference were evaluated and considered prior to finalizing this report.

Please review the final report and advise the Controller's Office by May 12, 2014 on planned actions you will take to implement the recommendations.

If you have any questions or comments, please contact me at (213) 978-7392.

Sincerely,

A handwritten signature in black ink, appearing to read 'Farid Saaffar'.

FARID SAFFAR, CPA
Director of Auditing

Enclosure

cc: Ana Guerrero, Chief of Staff, Office of the Mayor
Doane Liu, Deputy Mayor, Office of the Mayor
Miguel A. Santana, City Administrative Officer
Gerry F. Miller, Chief Legislative Analyst
Holly L. Wolcott, Interim City Clerk
Eric Paquette, President, Cultural Affairs Commission
Independent City Auditors



L.A. Public Art

Audit of the Los Angeles Department of Cultural Affairs' 1% for Arts Program

April 11, 2014



RON I GALPERIN
Los Angeles City Controller



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AUDIT OF THE LOS ANGELES DEPARTMENT OF CULTURAL AFFAIRS' 1% FOR ART PROGRAMS

EXECUTIVE SUMMARY

The Controller's Office has completed an audit of the 1% for Art Programs, managed by the Department of Cultural Affairs (Department). Since 1988, the 1% for Art Programs has been the catalyst for more than 1,000 murals, sculptures, monuments, memorials, fountains or other artist creations for the public to experience. As part of the audit, we examined the Department's processes to determine whether all 1% for Art fees applicable to both public and private developments are used in a timely manner to benefit the City's cultural landscape. These funds provide art throughout the City – making Los Angeles a more culturally enriching City. One of the important ways the City has sought to assert itself as the nation's creative capital is through the 1% for Art Program, which requires most commercial developments to set aside 1% for public art.

We initiated this audit because we found that the fund used to account for fees collected from developers rapidly increased, and we wanted to ensure that fees were spent on appropriate arts projects and activities. We found that the department has not developed spending plans for approximately \$7.5 million of the \$10 million in fees that have accumulated over the last seven years, thereby depriving the City of essential cultural enrichment. We also found that the Department needs to improve its management of the Developer-Led and Public Works' 1% for Art Programs to make art more accessible throughout the City.

I. BACKGROUND

The City of Los Angeles has established, through ordinance, two 1% for Art Programs for both public and private development projects.¹

1. **The Public Works Improvement Art Program (PWIAP)** requires that one percent of the cost of any City public works capital improvement project be set aside for an art component which is administered through the associated Arts and Cultural Facilities and Services Trust Fund (Fund #480). Since the Program's inception in 1988, the Department has helped administer approximately \$26 million, dedicated to more than 280 PWIAP art projects that are located at different public facilities throughout the City. Examples of current

¹ These programs do not include projects administered by Community Redevelopment Agency of Los Angeles or its successor agency, CRA/LA, a Designated Local Authority. This entity oversees its own 1% for Arts Fee Program for projects within its jurisdiction.

projects include some of the art installations in the renovated Tom Bradley International Terminal at the Los Angeles International Airport.

2. The Private Arts Development Fee Program (ADF Program) requires the owner of a private commercial or industrial development project (Developer) to pay a fee **or** to set aside funds for art, when applying for building permits with the City's Department of Building and Safety (DBS), as noted below:

2a. Developer Paid-In Projects (Developer Paid-In) require the Developer to pay a fee equivalent to one percent of the valuation of the project designed, as noted on the building permit(s), or an amount per gross square foot of any structure authorized by the permit(s), whichever is lower as determined by the Department of Building and Safety (DBS). When Developers pay this fee, it is remitted to DBS at the time a building permit is issued, and monies are deposited into the Arts Development Fee Trust Fund (Fund #516), by DBS. Resulting art projects paid from these fees are planned and implemented by the Department. The Department has collected approximately \$29 million in Arts Development Fees from owners of private commercial or industrial development projects, since the program began in 1991.

2b. Developer-Led Projects (Developer-Led), also called "In Lieu" projects, are those whereby the Developer agrees to design and construct an artistic or cultural amenity associated with its development at a cost equal to or greater than the Developer Paid-In arts fee the Developer would otherwise pay. For these projects, the Department grants a dollar-for-dollar credit against the Arts Development Fee, and the Developer must provide financial collateral payable to the City in the amount of the fee assessment, as surety that the planned commitment will be completed. According to the Department's internal database, since 1991 Developers have paid the equivalent of approximately \$37.6 million in Arts Development Fees to approximately 770 art projects associated with their developments.

The overall purpose of the 1% for Art Programs is to create art and provide support for cultural and artistic facilities and services in the community. The aim of the PWIAP is to utilize this one percent to contribute art experiences at public facilities in the City, while the private fees are used to support arts projects, facilities and arts educational programs available to the end users of the development site. The Department is responsible for managing these programs and for ensuring that the fees collected, and the amounts pledged by Developers for private projects and by the City for public improvement projects, are spent toward approved art and cultural projects.

II. OVERALL ASSESSMENT

Overall, our audit found that although there are opportunities for improvement for the PWIAP and Developer-Led Program, these programs have led to the creation of art

throughout the City. However, our audit found significant issues related to the Developer Paid-In Program, which has resulted in very few works of art or cultural activities for City residents to enjoy. For example, we noted:

- The Department has spent a limited amount on Developer Paid-In projects since 2008 due to tight restrictions placed on the use of the Developer Paid-In fees. As a result, \$10 million has accumulated in the Arts Development Trust Fund (Fund #516), of which the Department has not developed spending plans for approximately \$7.5 million.
- Since 1991, Fund #516 has earned \$2 million in interest, but it is unclear how much has been spent and the Department does not have a methodology to attribute earned interest to specific projects.
- The Temporary Public Arts Pilot Program was a way to both address the restrictions on the Paid-In Arts Development Fees *and* mitigate a budget shortfall.
- The methodology used to calculate the Arts Development Fee, which is to be adjusted annually based on the Consumer Price Index, has not been updated since the program's inception in 1991.
- The Department does not always enforce the project completion date for the Developer-Led projects.
- The City Attorney does not approve the Department's agreements for Developer-Led projects and the format and type of financial collateral instruments provided is inconsistent, which may limit the City's protection.
- The Paid-In and Developer-Led Arts Development Fee databases do not ensure consistent and reliable reporting.
- The Department does not submit an annual plan for expenditures for the PWIAP to City Council, as required by the Los Angeles Administrative Code.
- There is a risk that the 1% amount set aside for the Developer-Led projects may be used to finance construction costs for projects that integrate the art component directly into the development project.

The key findings noted from our audit are summarized below:

III. KEY FINDINGS

- 1. The Department has spent a limited amount on Developer Paid-In projects since 2008 due to tight restrictions placed on the use of the Developer Paid-In fees. As a result, \$10 million has accumulated in Fund #516, of which the Department has not developed spending plans for approximately \$7.5 million.**

As of March 31, 2013, the Arts Development Fee Trust Fund (Fund #516) had a cash balance of approximately \$10.2 million; a 500% increase from the June 30, 2006 balance of \$1.7 million. An average of \$1.3 million per year of Developer Paid-In fees has been deposited in Fund #516 since 2008, while only \$654,201 has been expended over that entire period.

As of June 30, 2013, the Department has collected Developer Paid-In fees for 373 projects that have had no expenditures or encumbrances, which have a combined total available balance of \$6.4 million. In each case, the fees were collected at least six months prior to June 30, 2013. In addition, as discussed further below, there is approximately an additional \$1.1 million in interest in Fund #516 that has not been attributed to specific projects. Despite the high cash balance and annual reporting requirements, the Department has not issued formal reports to Council detailing the amount in Fund #516, as required by the Los Angeles Administrative Code.

Prior to July 1, 2007 the Developer Paid-In fees were used to administer art related projects and services within the applicable Council District from which the fee was generated, and to augment general operations of the Department. The City Attorney has advised the Department that since the Los Angeles Municipal Code is based on the State Mitigation Fee Act, the City must demonstrate a **reasonable** relationship (i.e., a site demand nexus) between the development project and the impact of the fee. In addition, the language in the Municipal Code states that such “artistic facilities, services and community amenities will be available to the development project and its future employees.” Therefore, in 2007 the City Attorney narrowed the fee’s permitted use by instituting a “one-block geographical radius” restriction around the Developer Paid-In projects. The Department explained that this restriction has made it difficult to use any of the fees, and is the primary reason for the large accumulated balance.

We reviewed the practices of five other California cities that administer an Arts Development Fee Program, and noted that none of those cities’ programs adhere to such a narrow geographic radius. Some of these cities’ art programs are based on laws different than Los Angeles’ art programs. Consequently, they may have greater flexibility in their administration and use of the fees.

Further, although both the Developer Paid-In and Developer-Led Arts Development Fee programs appear to have the same objective, the programs are dictated by two different City governmental codes; and the services and programs for which the fees and credits can be utilized are inconsistent. The Developer-Led Program, which is dictated by the Los Angeles Administrative Code, includes specific examples of how the credit can be applied, whereas the language in the Municipal Code related to the Paid-In Program is broad and has been subject to various interpretations by the City Attorney.

The Department did spend approximately \$400,000 of the Developer Paid-In fees on 32 projects in fiscal years 2012 and 2013 in a Pilot Program. Most of these were for temporary art projects and several accounts have very small remaining balances. It is likely that these amounts will remain if there is no provision to consolidate them.

The Department issued the “Framework for Cultural Planning” in 2010 that included recommendations for various stakeholders specifically related to the City’s 1% for Art programs, inferring that the Department acknowledged that the programs were not operating effectively and there were opportunities for improvement. However,

management indicated that the Framework was never formally adopted by the Mayor or City Council; so the Department lacked the authority to enact it.

2. Since 1991, Fund #516 has earned \$2 million in interest, but it is unclear how much has been spent and the Department does not have a methodology to attribute earned interest to specific projects.

From 1991 through March 31, 2013, Fund #516 earned almost \$2 million in interest. The Department has not tracked how much of the \$2 million in interest has been spent. However, based on our inquiry, the Department determined that approximately \$1.1 million in interest remains in Fund #516. Since the Department lacks a methodology to attribute interest, interest earnings will continue to accumulate in the fund, and not be spent on art projects.

3. The Temporary Public Arts Pilot Program was a way to both address the restrictions on the Developer Paid-In Fees and mitigate a budget shortfall.

In 2011, the Department used a portion of the Developer Paid-In fees to administer a Pilot Program which included two components, which focused on temporary art projects. The “Expanded Cultural Arts Program” involved the Department’s Grant Administration Division matching 20 organizations which had previously received grants from the Department to development site addresses meeting the one-block radius restriction, and provided funding to the organizations for various art projects. The second component involved allocating the development fee associated with one large development to 12 artists whose pieces and/or performances were temporarily displayed at a park across the street from the development site.

Generally, Pilot Programs are implemented on a limited basis and quickly evaluated to determine whether or not they should be continued and expanded to meet the organization’s objectives. However, this Pilot Program, which began in 2011, has not been formally evaluated by the Department to determine whether it should develop formal guidelines and continue administering the Arts Development Fees using this approach. The Department indicated the final reports for the last five projects were submitted to the Department in early 2013 and it plans to evaluate the program shortly.

While the Department attempted to address the geographic restrictions placed on the fees, the Pilot Program also enabled the Department to supplement an existing Departmental grant program during a budget shortfall. If the Department believes that the Pilot Program is a viable solution, it should work with the CAO to consider supplementing the line item in their annual budget for the grant program with a portion of the collected Arts Development Fees.

4. The methodology used to calculate the Arts Development Fee, which is to be adjusted annually based on the Consumer Price Index, has not been updated since the program’s inception in 1991.

The Developer Paid-In fee requires the Developer to pay a fee equal to one percent of the valuation of the project as designated on the building permit or an amount per gross square foot of any structure authorized by the permit, *whichever is lower*. Per the Los Angeles Municipal Code, the Department is required to revise the Arts Development Fees annually by an amount equal to the Consumer Price Index for Los Angeles published by the U.S. Department of Labor. Revised amounts should then be submitted to Council for adoption by ordinance. However, we found that the dollar per square foot amounts have not been revised since the ordinance was originally adopted in 1992.

A Nexus Study conducted in 1991 concluded that the City would be justified in using a rate as high as 3.74% of the permit valuation, but at that time the City Council expressed its intent to limit it to a maximum of 1%. Since more than 20 years have passed since the Arts Development Fee Ordinance was adopted, the Department should review both the CPI and the 1% to ensure the City is collecting the appropriate amount of Developer Paid-In fees. According to data maintained by the Bureau of Labor Statistics, the CPI in Los Angeles increased approximately 58% from 1992 through 2012. By not revising the rates according to the CPI, the City could be losing as much as 58% in fee revenue for some projects.

5. The Department does not always enforce the project completion date for the Developer-Led projects.

Rather than paying the Arts Development Fee, a Developer has the option of designing and implementing an artistic or cultural amenity associated with their development site at a value that is at least equal to the fee they would otherwise pay. With this option, the Developer must provide financial collateral, generally a Certificate of Deposit (CD) or a Letter of Credit (LOC) noting the City as the beneficiary, as surety that the arts project will be completed as approved by the Department; a term of agreement form developed by the Department is also included. If an art project does not materialize or comply with the agreement, the City may redeem the CD or the LOC. We found three Developer-Led projects which total \$21,000 with target completion dates of October 2007 but remain “active” almost six years later.

6. The City Attorney does not approve the Department’s agreements for Developer-Led projects and the format and type of financial collateral instruments provided is inconsistent, which may limit the City’s protection.

The standard terms of agreement form which accompanies the financial collateral instrument is signed only by the Developer and the Department General Manager. Generally, any financial agreement that a City department enters into should be reviewed and approved by the City Attorney to ensure that the City is adequately protected from risk, and to enable the City to enforce the contract and withstand any challenges. The Department indicated that the City Attorney’s Office reviewed and approved a template several years ago. However, staff was unable to provide documented evidence of the approval.

The format and types of the financial instruments provided to the Department are inconsistent. While they are labeled Certificates of Deposits or Letters of Credit, how they are addressed and completed varies. For example, one LOC was addressed directly to the City of Los Angeles, not the Department, while another CD did not even have the City of Los Angeles or the Department as the listed beneficiary. With such inconsistencies and without formal legal review, the City's ability to redeem the collateral is questionable.

7. The Paid-In and Developer-Led Arts Development Fee databases do not ensure consistent and reliable reporting.

Both the Paid-In and Developer-Led Arts Development Fee projects are tracked in Access databases, which have been used since 2007. Department staff uses the databases for maintaining Developer information, the status of the project, and correspondence notes. We found that some fields within the databases are redundant and others are inconsistent. Since generating reports requires staff to select specific options for each field, there is a high risk that any resulting reports will have errors or missing information, compromising the Department's ability to effectively manage the programs.

8. The Department does not submit an annual plan for expenditures for the Public Works Improvement Art Program.

The Los Angeles Administrative Code requires the Department to prepare an annual plan for expenditures from the Arts and Cultural Facilities and Services Trust Fund (Fund #480). However, according to the Department, most of the PWIAP projects are financed with bonds or through multiple sources which do not allow for a transfer of the entire amount into Fund #480 at one time, making it difficult to comply with the specific reporting requirement. Allowable administrative costs incurred by the Department to manage the program are charged directly to the City Department responsible for the construction project, rather than encumbered from the Fund along with other arts-related expenditures.

The Department believes it meets the intent of this requirement because PWIAP project plans are submitted to their Commission for review and approval on an individual basis, and it provides status updates of active projects to the Commission during their monthly meetings. Management indicated that this is another example of how the Administrative Code is not in line with current conditions or processes or reflective of how the Department must address the funding sources.

In order to adequately comply with the Administrative Code and ensure that overall PWIAP funding is planned and reported in an effective manner, the Department should submit an annual expenditure plan to City policymakers that includes all PWIAP projects and anticipated expenditures, including administrative costs charged by the Department. If the Department can sufficiently demonstrate that the program funding structure has evolved and the requirement in the Administrative Code is no longer

applicable, management should work with policymakers and the City Attorney to revise the language in the Administrative Code, and reconsider the necessity of the Trust Fund.

9. There is a risk that the 1% set aside for the Developer-Led projects may be used to help finance construction costs for projects that integrate the art component directly into the development project.

During the audit, we noted some Developers who select the Developer-Led option and manage the art project themselves will incorporate the art component directly into their development site. In these instances, the art is integrated into a functional and required element of the development project, as opposed to a stand-alone piece. In an effort to prevent Developers from applying the fee towards construction costs that integrate the art directly into the development, Administrative Code section 22.118 (2) (g) specifically states that the fee amount **cannot** be used on “*Decorative, ornamental, or functional elements which are designed by the building architect as opposed to an artist commissioned for this design enhancement purpose.*” Departmental management explained that prior to approval, the Developer-Led projects are reviewed only by staff, whereas PWIAP project budgets are reviewed by multiple stakeholders, including the Public Art Committee, the Cultural Affairs Commission, the lead agency and the CAO. Despite the increased scrutiny of PWIAP projects, the Department still lacks detailed procedures and guidelines for both Developer-Led and PWIAP projects, to ensure the 1% arts fee is not used to finance the construction costs inherent to the development project.

These findings and related recommendations are discussed in more detail in the body of this report.

IV. REVIEW OF REPORT

On August 30, 2013, a draft report was provided to Department management. We held an exit conference with Department representatives on September 12, 2013 to discuss the contents of the audit report. Department management indicated general agreement with the findings and recommendations and provided some additional information for consideration by the auditors.

We also discussed the draft report with the City Attorney. With respect to the narrow geographic restriction placed on the fees collected, the City Attorney indicated that it has reviewed the legal options and has determined that there is more flexibility for the use of funds consistent with a 1991 Nexus study and the law. The City Attorney stated it is committed to working with City stakeholders, including the Department, to define new parameters for the expenditure of funds.

We considered comments provided by the Department before finalizing this report. We would like to thank Department management and staff for their cooperation and

assistance during the audit. Certain information, due to its confidential nature, has been omitted from this report based on recommendation of counsel.

V. SUBSEQUENT EVENT

On October 28, 2013, subsequent to audit fieldwork, the Budget and Finance committee instructed the Chief Legislative Analyst (CLA) to report back regarding the options available to expand the allowable uses of the Arts Development Fees.

AUDIT ACTION PLAN

RECOMMENDATIONS	PAGE	MAYOR/COUNCIL ACTION REQ'D	DEPARTMENT ACTION REQ'D
SECTION I. ARTS DEVELOPMENT FEE DEVELOPER PAID-IN PROJECTS			
1. Cultural Affairs Management should solicit feedback from Developers to understand how they view the City's Arts Development Fee program and consider their input when revising any related ordinances.	31		Department of Cultural Affairs (DCA)
2. Cultural Affairs Management and City Council should consider reviewing and resolving any discrepancies in the relevant sections of the Administrative Code (Paid-In Fees) and the Municipal Code (Developer-Led Credits) which dictate the services and programs for which the fees and credits can be utilized.	31	City Council	DCA
3. Cultural Affairs Management and City Council should consider developing a "Cluster" Model, which would allow the Department to group Arts Development Fees that fall within a reasonable distance from the development site and administer them in a consolidated manner.	31		

RECOMMENDATIONS	PAGE	MAYOR/COUNCIL ACTION REQ'D	DEPARTMENT ACTION REQ'D
4. Cultural Affairs Management should determine, in conjunction with the City Attorney, how to address the high cash balance in Fund #516 so that the accumulated Arts Development Fees and interest are used to fund publicly accessible art projects and/or cultural programs in a more timely manner.	31		DCA
5. Cultural Affairs Management should complete and submit the required quarterly and annual reports to City Council which detail the activities in Fund #516 to allow for a timely discussion among policy makers to determine how any unused Arts Development Fees should be reallocated.	31		DCA
6. Cultural Affairs Management should, in consultation with the Controller's Office, immediately establish a method to attribute interest earnings that is consistent with the Administrative Code.	33		DCA
7. Cultural Affairs Management should consider a method which will allow the interest from multiple sites to be leveraged so larger art projects can be made available throughout the City.	33		DCA
8. Cultural Affairs Management should establish adequate controls to ensure that interest credited to Fund #516 is attributed in a timely manner, in accordance with the established methodology.	33		DCA
9. Cultural Affairs Management should evaluate the results of the Pilot Program.	34		DCA

RECOMMENDATIONS	PAGE	MAYOR/COUNCIL ACTION REQ'D	DEPARTMENT ACTION REQ'D
10. If the Pilot Program is deemed successful, Cultural Affairs Management should work with the CAO to consider allocating a portion of the Paid-In Development Fees to the Grants Administration Division's annual budget to provide funding to organizations that provide services within the (revised) allowed radius of the development generating the fee.	34		CAO
11. Cultural Affairs Management should comply with the Municipal Code and provide the updated fee rates to City Council for consideration.	36		DCA
12. Cultural Affairs Management should work with the City Administrative Officer and City Council to evaluate whether the 1% cap should be reassessed.	36		DCA
13. Cultural Affairs Management should review the fields in the Developer Paid-In Development Database, and work with ITA to modify and eliminate redundant options in order to simplify reporting.	37		DCA
SECTION II. ARTS DEVELOPMENT FEE DEVELOPER-LED PROJECTS			
14. Cultural Affairs Management should on a monthly basis, generate a report of active projects which lists the anticipated completion dates and the financial collateral instrument expiration dates to ensure the deadlines have not passed, and notify Developers with approaching deadlines to ensure program requirements are enforced.	40		DCA

RECOMMENDATIONS	PAGE	MAYOR/COUNCIL ACTION REQ'D	DEPARTMENT ACTION REQ'D
<p>Cultural Affairs Management should:</p> <p>15. a) Obtain formal approval from the City Attorney for a standard agreement template that is consistent with City contracts, and determine the approval process for the individual agreements and related financial collateral instruments.</p> <p>b) Consider collecting a financial collateral instrument from the Developer, only when they fail to complete the art component. The certificate of occupancy should be withheld until either the art component is completed or until the Developer has provided the City with an acceptable financial collateral instrument.</p>	41		DCA
<p>16. Cultural Affairs Management should instruct the Developers to designate the City of Los Angeles, Department of Cultural Affairs, as the beneficiary of the selected financial collateral document.</p>	41		DCA
<p>17. Cultural Affairs Management should review the fields in the Developer-Led Database to limit excessive options and work with ITA to modify and eliminate redundant options.</p>	42		DCA

RECOMMENDATIONS	PAGE	MAYOR/COUNCIL ACTION REQ'D	DEPARTMENT ACTION REQ'D
SECTION III. PUBLIC WORKS IMPROVEMENT ARTS PROGRAM			
18. Cultural Affairs Management should submit an annual plan for the use of all PWIAP funds to the Cultural Affairs Commission, Mayor and Council for review and approval.	44		DCA
SECTION IV. ADDITIONAL OBSERVATION			
19. Cultural Affairs Management should revise the Developer-Led and PWIAP guidelines to require staff to compare the art component plan against the development construction costs to ensure it will only be used for materials and labor exclusively for the project, and not to finance incremental construction costs of the development/project.	47		DCA

INTRODUCTION AND BACKGROUND

Population growth and subsequent development tend to impact a City's ability to easily incorporate art and culture into its landscape. To alleviate this burden, several cities across the country mandate the collection of Arts Development Fees from property Developers as they plan for new construction. In some cases, these are referred to as "mitigation fees" because they are used to mitigate the effects of land use development, such as inconveniences suffered during the construction process or for environmental impacts caused by the new structures.

Over time, both the nature of development fees and the ability to collect them have evolved. As early as the 1920s, local governments collected impact fees or "exactions," which required land Developers to set aside land at the site of construction to provide public space and services. In 1987, the State of California passed the Mitigation Fee Act², which codified the collection and use of development fees. The historical context for the State's Act dates back to the passage of Proposition 13 in 1978, which limited the amount of property taxes that can be collected. Since property taxes were severely restricted, government entities looked to Developers for additional revenue, and significantly increased development fees. In response to concerns of overburdening Developers with fees, the Mitigation Fee Act was passed which restricted the amount of, and how the development fees could be collected and used. Specifically, the Act mandates that a jurisdiction demonstrate a reasonable relationship (i.e., a site demand nexus) between the development project and the impact of the fee, and requires a municipality to demonstrate the legitimacy of a development fee in the form of a nexus study.³ The City formally explored the justification and application of the Arts Development Fee in 1991, when it commissioned the "Nexus Study of the Linkage between Commercial and Industrial Development and Cultural and Artistic Facilities, Services, and Community Amenities in the City of Los Angeles."

"1% for Art" Programs

In 1988, the City of Los Angeles passed ordinance No. 164244 which authorized the Public Works Improvement Arts Program (PWIAP). The Program requires that one percent of the cost of any City public works capital improvement project be set aside for an art component which is administered through the associated Arts and Cultural Facilities and Services Trust Fund (Fund #480).

The City continued its effort to make art accessible for residents by establishing the Arts Development Fee Trust Fund (Fund #516) in 1991 via Ordinance No. 166725. This requires the private owner or Developer of a commercial or industrial development

² Also known as California Code Section 66000

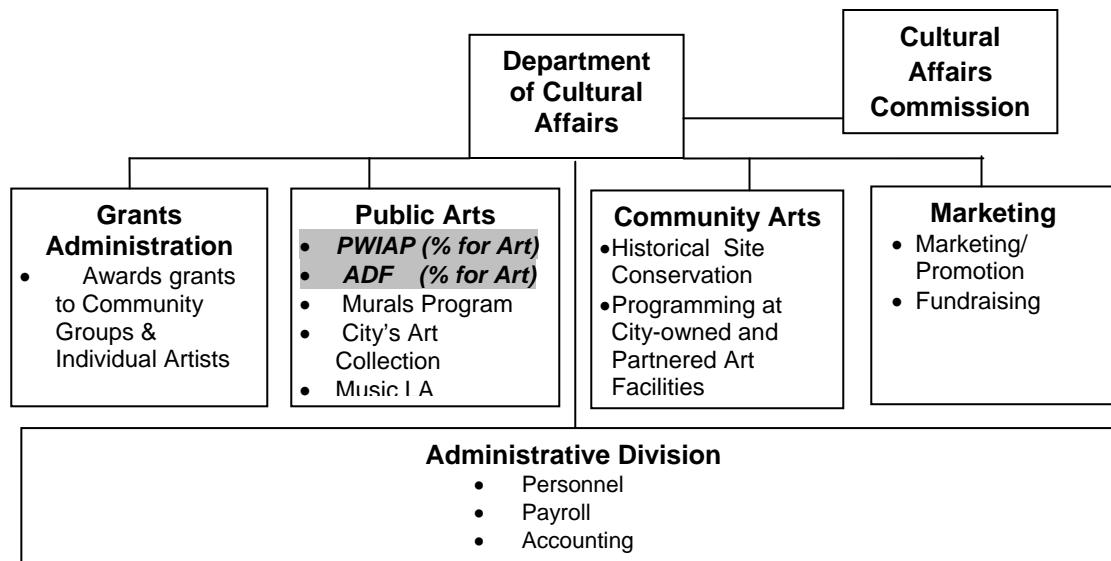
³ The research must determine: 1) The purpose of the fee; 2) The use of the fee; and 3) The reasonable relationship between the fee's use and the type of development project.

project to pay a fee or set aside funds for art when applying for building permits with the City's Department of Building and Safety (DBS).⁴ Since then, several cities have passed "1% for Art" ordinances which dedicate a set percentage (usually 1%) of the cost of new construction to purchase or support public art.

Department of Cultural Affairs

The Department of Cultural Affairs (Department) administers both the Public Works Improvement Arts Program (PWIAP) and the Arts Development Fee Program, and is also tasked with generating and supporting high quality arts and cultural experiences for the City of Los Angeles. The Department works with the Cultural Affairs Commission (CAC), whose members are appointed by the Mayor and serve as an advisory body to the Department. The CAC approves the design of structures built on or over City property, and accepts works of art that are acquired by the City.

In Fiscal Year 2013, the Department had an operating budget of approximately \$8.1 million, and 41 budgeted full-time positions, which supports its five divisions and their respective functions as shown below:



The vast majority of the Department's operating budget is funded by a percentage of the City's Transient Occupancy Tax that flows through the General Fund. However, the Department also obtains funding from the Arts Development Fees, grants and private donations.

The Department's overall vision is intended to be guided by the "City of Los Angeles Cultural Master Plan," which was adopted by the Mayor and City Council in 1992. The Plan includes 16 goals for the City's cultural future, which are organized around seven areas of municipal activity; 1) Art in the City, 2) Equity and the Arts, 3) Developing the

⁴ Where there are combined uses within a development project or portion thereof, the arts fee shall be the sum of the applicable fee requirements.

Artist, 4) Developing the Audience, 5) Youth and Education, 6) the Visual Landscape and 7) the Cultural Infrastructure.

PUBLIC WORKS IMPROVEMENT ARTS PROGRAM (PWIAP)

The Public Works Improvement Arts Program (PWIAP) requires that when the City initiates a public works building project, 1% of the **total** budget be set aside for an art component and used exclusively for:

- ✓ Acquisition or placement of publicly accessible works of art
- ✓ Acquisition or construction of arts and cultural facilities
- ✓ Providing art and cultural services
- ✓ Restoration or preservation of existing works of art
- ✓ City's cost of administering the PWIAP
- ✓ Support to program operations of the Department of Cultural Affairs

City departments that typically initiate PWIAP projects are those that have significant infrastructure needs and have secured capital funding, such as the Harbor, Airports, Water and Power, Police, Fire, and Animal Services.

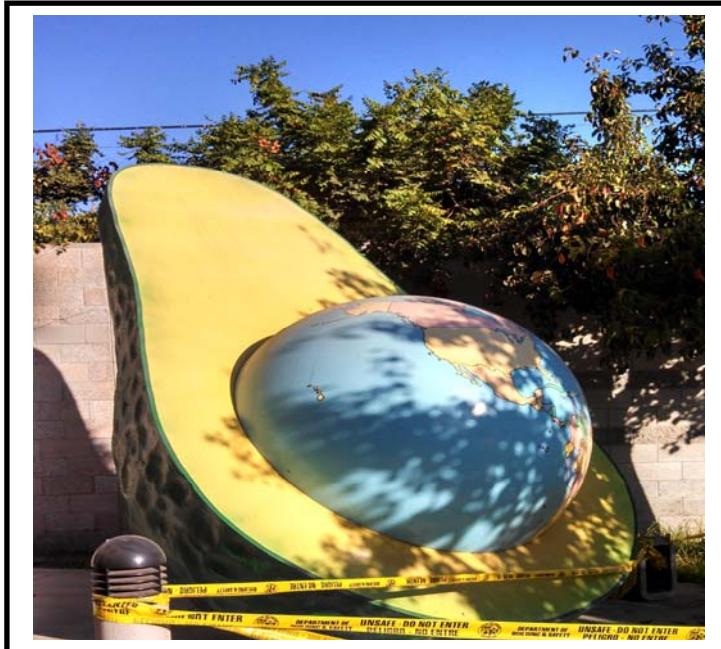
Case Study Planning the 6th St. Viaduct Replacement

The Bureau of Engineering oversees the City's Bridge Improvement Program, which involves the strengthening and upgrading of 83 City bridges. The 6th St. Viaduct Replacement is one of the most significant projects in the City, and includes a \$1.65 million arts component under the PWIAP.

A project of this scale required more intense involvement from Department staff, who attended monthly executive meetings, "Design Aesthetic Advisory Committee" (DAAC) meetings and the public presentations made by consultants. Ultimately, the Department recommended the formation of a Professional Arts Advisory Committee (PAAC) to provide the Department with assistance, guidance and expertise during the development of the artistic vision for the 6th St. Viaduct public art project. Members include art professionals, project consultants, and the associated Council District. The PAAC was established in February 2013.



EAST VALLEY SANITATION FACILITY
"FRUITS OF LABOR"
PWIAP = \$178,000



Since the Program's inception in 1988, the Department has helped administer approximately \$26 million, dedicated to over 280 PWIAP art projects that are located at different public facilities throughout the City.



**EAST VALLEY SANITATION FACILITY
EXTERIOR INSTALLATION
PWIAP= \$178,000**



ARTS DEVELOPMENT FEE (ADF)

The Private Arts Development Fee Program (ADF Program) requires the owner of a private commercial or industrial development project (Developer) to pay a fee **or** to set aside funds for art, when applying for building permits with the City's Department of Building and Safety (DBS). If funds are paid, they are deposited into the Arts Development Fee Trust Fund (Fund #516). Per the Municipal Code, the funds are supposed to be used in accordance with the City's Cultural Master Plan.

Arts Development Fee Exemptions

1. Projects with total construction value of \$500,000 or less.
2. Projects where repairs and/or renovations of a building do not alter the size or occupancy load of the building.
3. Projects where the repair and/or renovation of a building is for the installation of fire sprinklers.
4. Projects where the repair and/or renovation of a building is made to comply with a citation involving Earthquake Hazard Reduction in Existing Buildings.
5. Projects where the repair and/or renovation of a building is for any handicapped facilities pursuant to the Municipal Code.
6. Residential buildings, except hotels.

“Paid-In” Fee

The “Paid-In” fee requires the Developer to pay a fee equal to one percent of the valuation of the project designed, as noted on the building permit, **or** an amount per gross square foot of any structure authorized by the permit, whichever is lower as

determined by DBS. If the Developer opts to pay the fee, it is paid to DBS at the time they obtain a building permit.

Examples of Paid-In projects include the following:

- A theatre group performed a reading of a play about military veterans returning home. Costco was the developer, and the performance was delivered at a nearby school.
- A paid fee supplemented the budget for the Hollywood Arts Council, Children's Festival of the Arts, which was held on the lot of Paramount movie studios, who was the Developer.
- A fee was used to promote the Los Angeles Contemporary Exhibition Gallery's exhibition of "Los Angeles Goes Live: Performance Art on Southern California 1970-1983 for 3 weeks. The banners were attached to the street lights/poles in the adjacent blocks to the Gallery, which was the Developer.

fee was collected." The Department has collected approximately \$29 million in Developer Paid-In fees since the program began in 1991.

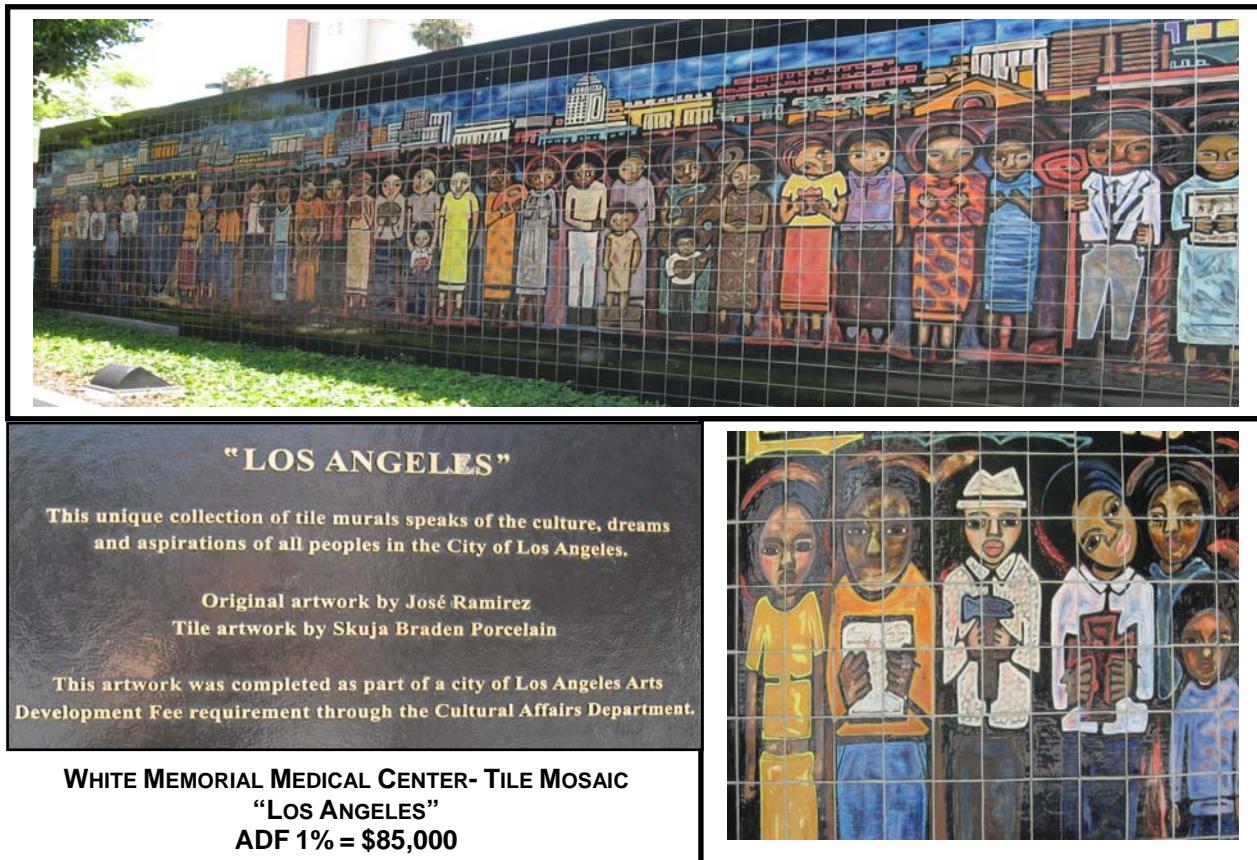
When a fee is paid, the Department sets up an individual appropriation account within Fund #516 for that specific development site address. For example, if the Developer pays a fee of \$20,000 for a project located at 111 Central Avenue, staff will set up appropriation account A111 and this account will only include the \$20,000 amount, which can only be expended on behalf of the project at 111 Central Avenue. This is to ensure that the Department is in compliance with the State code which requires it to deposit the funds, "in a manner to avoid any comingling of the fees with other revenues and funds.... and expend those fees solely of the purpose for which the

Developer-Led/“In-Lieu” Projects

In lieu of paying the fee, Developers have the option of designing and constructing an artistic or cultural amenity associated with their property at a cost equal to or greater than the dollar amount of the Arts Development Fee they would otherwise pay. This is informally referred to as an "In-Lieu" project, (also referred to as Developer-Led) and the Department grants a dollar-for-dollar credit against the Arts Development Fee. If the In-Lieu option is selected, the Developer must also provide financial collateral made payable to the City, in the dollar amount of the fee assessment, as surety that the planned commitment will be completed. Examples of Developer-Led projects include the following:

- The Developers of Playa Vista constructed three different projects throughout the planned community. In addition to two large art installations, they built a large permanent amphitheater with a stage in which festivals and performances can be programmed throughout the year.
- An on-site mosaic wall piece was installed in front of escalators in the entry way of a commercial retail development.
- A Developer bought several art pieces and prints and displayed them in its office space.

- The Developer of an industrial warehouse commissioned the construction of a bronze sculpture, which is located in the entry courtyard.
- At White Memorial Medical Center, the Developer commissioned an artist to install tile mosaic murals to wrap around the parking lot exterior walls. (See picture below)



According to the Department's internal database, since 1991 private Developers have paid the equivalent of approximately \$37.6 million dollars in fees to approximately 770 art projects associated with their developments.

Below is a table which summarizes all three 1% for Art Programs, as administered by the Department.

SUMMARY OF THE CITY OF LOS ANGELES' 1% FOR ART PROGRAMS*			
	PUBLIC WORKS IMPROVEMENT ARTS PROGRAM (PWIAP)	DEVELOPER PAID-IN	DEVELOPER-LED
FUNDING SOURCES/PAYMENT METHOD	1% of the total cost of construction from public works capital improvement projects. (This does not include property acquisition costs, or non-construction costs.)	The Developer pays a fee equal to 1% of the valuation of the project designed, as noted on the building permit, or an amount per gross square foot of any structure authorized by the permit, whichever is lower as determined by DBS. The fee is paid to DBS at the time a building permit is obtained.	The Department grants a dollar-for-dollar credit against the Arts Development Fee that would be due. If this option is selected, the Developer must also provide financial collateral made payable to the City, in the dollar amount of the fee assessment, as surety that the planned arts commitment will be completed.
EXEMPTIONS	If applicable law or the source of funding for the project prohibits use for art. <i>For example, the Federal Aviation Administration's (FAA) Airport Improvement Program does not allow funding to be used on artwork.</i>	Projects with a total construction value of \$500,000 or less. Projects where repairs and/or renovations of a building do not alter the size or occupancy load of the building. Projects where the repair and/or renovation of a building is for the installation of fire sprinklers. Projects where the repair and/or renovation of a building is made to comply with a citation involving Earthquake Hazard Reduction in Existing Buildings. Projects where the repair and/or renovation of a building is for any handicapped facilities pursuant to the Municipal Code. Residential buildings, except hotels.	
ALLOWABLE PROJECTS/EXPENDITURES	Acquisition or placement of publicly accessible works of art. Acquisition or construction of arts and cultural facilities. Providing art and cultural services. Restoration or preservation of existing works of art. Supporting the City's cost of administering the PWIAP. Support to program operations of the Cultural Affairs Department.	Fees paid into this fund may be used only for the purpose of providing cultural and artistic facilities, services and community amenities which will be available to the development project and its future employees.	The subject facility, service or community amenity: (a) may be used by the patrons, occupants and owners of the development project; and (b) satisfies the cultural and artistic needs of the development project so as to reduce the need for public cultural and artistic facilities, services and community amenities to serve the patrons, occupants and owners of the development project.

*This table does not include projects administered by Community Redevelopment Agency of Los Angeles or its successor agency, CRA/LA, a Designated Local Authority. This entity oversees its own 1% for Art Fee program for projects within its jurisdiction.

OBJECTIVES, SCOPE AND METHODOLOGY

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

We conducted the audit primarily between February 2013 and July 2013. The primary objective of this audit was to determine whether the arts programs are being overseen properly and result in the desired outcomes. Other objectives included the following:

- 1) To evaluate whether arts fees collections were used in accordance with the Ordinance establishing the fee.
- 2) To evaluate the reasonableness of the balance in Fund #516, in relation to the Department's spending plan.
- 3) To evaluate credits given to Developers in lieu of the Arts Development Fees assessment.
- 4) To assess the efficiency and effectiveness of the Arts Development Fee program activities, (including planning, monitoring and reporting) to ensure the Department is meeting established program goals and outcomes.

The audit reviewed focused on activities between July 1, 2009 and March 31, 2013. In conducting our audit, we:

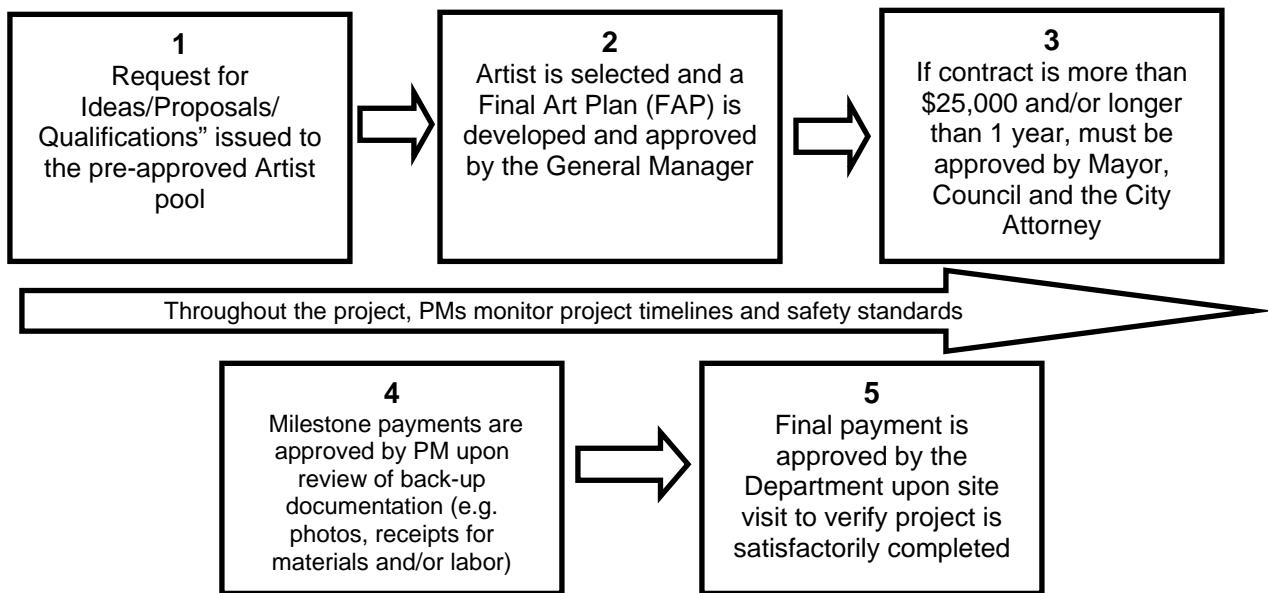
- ✓ On a sample basis, reviewed project files for the PWIAP and Developer-Led Programs
- ✓ Reviewed the Access databases used to track the Arts Development Fees
- ✓ Interviewed Department and City Attorney staff
- ✓ Reviewed the financial transactions in Fund #516
- ✓ Compared the Department's practices with five other California Cities that collect Arts Development Fees
- ✓ On a sample basis, traced Arts Development Fees due and collected for private developments per the Department of Building and Safety's records to the Department's databases used to track fees and manage projects.

AUDIT FINDINGS AND RECOMMENDATIONS

Section I: Arts Development Fee Developer Paid-In Projects

If a Developer opts to pay the Arts Development Fee, rather than committing to fund an “In-Lieu” art project associated with their development, it is paid to the Department of Building and Safety (DBS) at the time they obtain their building permit. Each month, Department staff reviews the Arts Development Fee Report on DBS’ website to confirm any new projects, which are then assigned to a Public Art Project Manager (PM), who is responsible for both the design and management of the Paid-In projects. Per the Los Angeles Administrative Code, 18% (of the 1% assessment fee) may be used for project administration. The Department developed the following project management processes for the pilot projects:

Exhibit 1.1
Arts Development Fee; Developer Paid-In Project Processes



While the Department has established the processes and procedures detailed in Exhibit 1.1, until Fiscal Year 2012-13 they had not been implemented because the Department had initiated very few projects before then, as discussed in detail below.

Finding No. 1: The Department has spent a limited amount on Developer Paid-In projects since 2008 due to tight restrictions placed on the use of the Developer Paid-In fees. This resulted in \$10 million accumulating in Fund #516, of which the Department has not developed spending plans for approximately \$7.5 million.

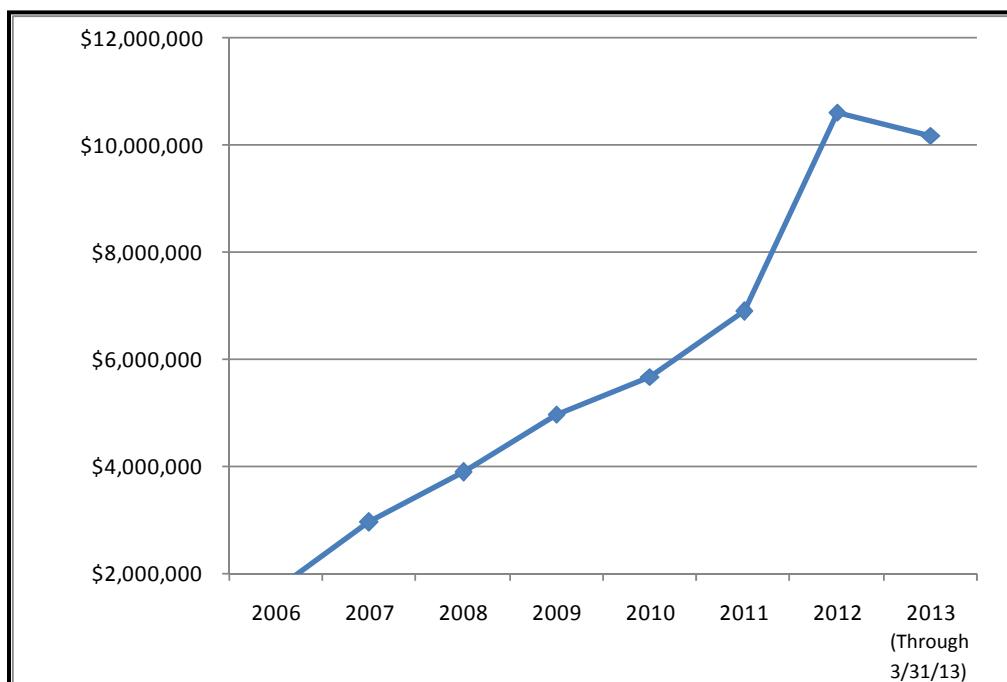
A significant amount of money has accumulated in the Fund and has not been committed, even though this is required by the Los Angeles Municipal Code, as stated in section 91.107.4.6.5;

"At or about the time of collection of any fee imposed by this section, the Cultural Affairs Department shall identify the use to which the arts fee is to be put, and if the use is financing public facilities, the facilities shall be identified."

Further, the Department has not provided any formal reports to the City Council alerting them of the total amount that has accrued in the Fund. As of March 31, 2013, Fund #516 had a cash balance of approximately \$10.2 million; this is a 500% increase from the June 30, 2006 balance of \$1.7 million. Of the \$10.2 million, approximately \$1.7 million relates to proprietary departments. The City Attorney has determined that the funds collected from the proprietary departments are to be accounted for similar to funds collected from private Developers. Therefore, the art fees generated by new development at these sites are accounted for in the Arts Development Fee Fund #516, rather than the Public Works Improvement Arts Program Fund #480. The three proprietary departments include the Los Angeles World Airport (LAWA), the Port of Los Angeles (Port), and the Los Angeles Department of Water and Power (DWP). However, for project management purposes, the Department generally tracks projects associated with proprietary departments in the PWIAP database.

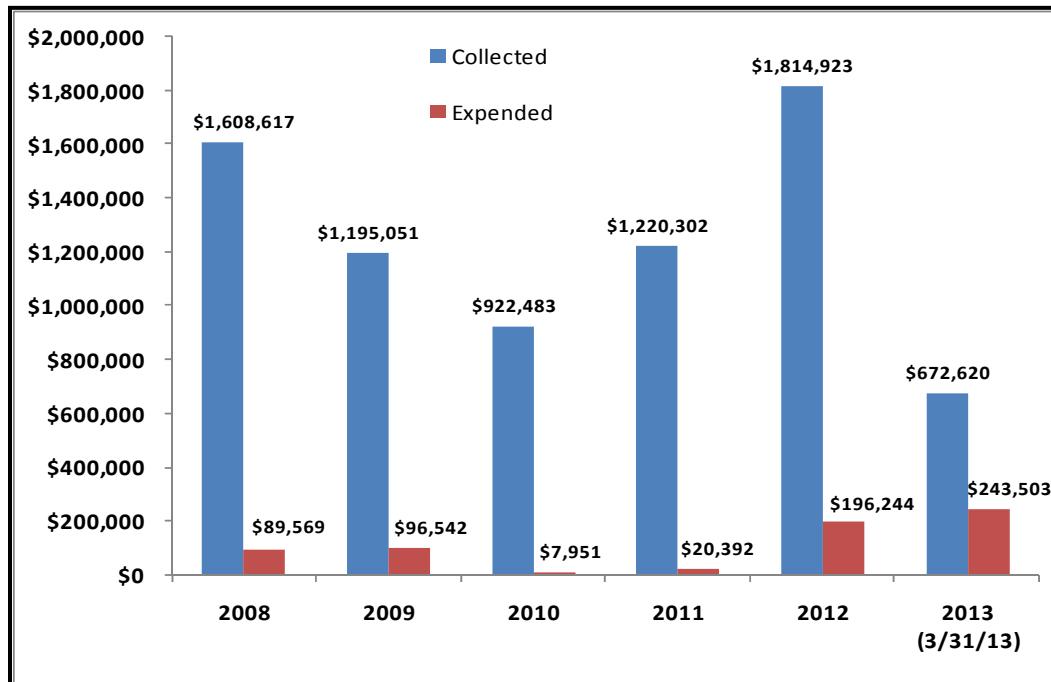
The greatest increase in the cash balance occurred in Fiscal Year 2011-12, when the Fund increased by \$3.7 million. Approximately \$2 million of this increase relates to art projects associated with the modernization of the Airport's international terminal, where federal funds were not used.

**ARTS DEVELOPMENT FEE FUND # 516
CASH BALANCE AT THE END OF FISCAL YEAR**



However, even when the Developer Paid-In fees are isolated, (i.e., excluding proprietary departments) an average of \$1.3 million has been deposited in Fund #516 each year since 2008, totaling \$7.4 million, while only a total of \$654,201 has been expended over that same period.

Developer Paid-In Fees Collected and Expended 2008 through 3/31/13



The chart below shows that as of June 30, 2013, the Department had 373 projects for which a fee was collected between December 2006 and January 2013, but had no associated expenditures or encumbrances since the fees were collected. The Department has not established a spending plan for any of these projects, which have a combined total available balance of \$6.4 million. No monies from these accounts have been spent or encumbered, and the Department has not developed a spending plan for any of these monies.

BREAKDOWN OF UNCOMMITTED FUNDS WITHOUT ANY EXPENDITURES OR ENCUMBRANCES AS OF 6/30/13		
Date Collected	# of Projects	Total Uncommitted Amount
Six months to one year (7/1/12 to 12/31/12)	34	\$503,930
One to two years (7/1/11 to 6/30/12)	63	\$1,348,280
Two to three years (7/1/10 to 6/30/11)	71	\$1,041,317
Three to four years (7/1/09 to 6/30/10)	48	\$636,036
Four to five years (7/1/08 to 6/30/09)	67	\$1,178,902
Five to six years (7/1/07 to 6/30/08)	63	\$981,095
Over six years (before 7/1/07)	27	\$698,971
Total	373	\$6,388,531

Also, as discussed further in Finding #2, there is an estimated \$1.1 million in accumulated interest earnings that should be attributed to specific projects. Thus, there is as much as \$7.5 million in available funds that do not have spending plans.

Despite the high cash balance and a 2007 Budget and Finance Committee motion that instructed the Department to provide each Council Office with information relative to the amount of fees collected and expended on a quarterly basis, the Department has not issued formal reports to Council detailing the amount in Fund #516. The lack of formal reporting also is inconsistent with section 5.346 (c) of the Los Angeles Administrative Code, which states:

“Once each fiscal year, the City Council shall make findings with respect to any portion of the fee remaining unexpended or uncommitted in this Fund five or more years after deposit of the fee. These findings shall identify the purpose to which the fee is to be put and to demonstrate a reasonable relationship between the fee and the purpose for which the fee was charged.”

Although the Administrative Code is directed at Council, it is incumbent upon the Department to provide the relevant information on an annual basis to Council in order to ensure compliance with the code.

Geographic Restrictions

Department staff explained, and documents indicate, that prior to July 1, 2007 the Developer Paid-In fees were used to administer citywide art related projects and services and to augment (for one year) Departmental operations. In June 2006, the City Attorney’s Office reviewed the relationship between the Municipal Code and the use of the fees and found that using them in this way was improper. The City Attorney advised the Department that since the Municipal Code is based on the State Mitigation Fee Act,

the City must demonstrate a **reasonable** relationship (i.e., a site demand nexus) between the development project and the impact of the fee.

It appears that the City Attorney determined that this language and the term reasonable implies that there should be a geographic relationship placed on how and where the fee can be used. In 2007, the City Attorney advised the Department to stop using the fee for the Department's general operations and to limit permitted use of the fee to a "one-block geographical radius" around each Arts Development Fee project. The Department contends that this very narrow geographic restriction has made it difficult for them to use the fees, and is the primary reason for the accumulated large Fund balance.

Department efforts

During the period from 2006 through 2011, Department management indicated that they attempted to work with staff from the Office's of the Mayor, City Controller, City Attorney, CAO and Council members, to address the issues related to the program and the large Fund balance. They provided several documents to the audit team which detailed their efforts to work with stakeholders and Council members. However, as the monies continued to accumulate in Fund #516, Department management did not raise the issue with the full Council. Formally submitting the required quarterly and annual reports of activities could have resulted in the City taking action to address this issue. The issue of accumulated funds was discussed during the Department's budget hearing in May 2013, during which a Councilmember requested the City Attorney to review and report back on the current Municipal Code and identify possible ways to update it so the Department can more easily use the fees.

The Department did spend approximately \$400,000 of the Arts Development Fees on 32 projects in fiscal years 2012 and 2013, in a Pilot Program. Most of these were for temporary art projects; and several of the accounts which funded the programs have remaining balances of less than \$2,000, with one having a balance of just \$200. If the specific narrow geographic restrictions continue to be required, it is unlikely that these small amounts will be used, because individual projects or cultural services generally require more funding. Consequently, there is a risk that these smaller amounts will remain unspent unless there is a provision to consolidate them.

Benchmarking

During the audit, we reviewed the practices of five other California cities⁵ that administer an Arts Development Fee program. Staff that manage these cities' programs explained that they do not adhere to a narrow geographic radius. Consequently, they have greater flexibility in their administration of the collected fees. However, one point to consider is that Los Angeles is much larger geographically than these other cities. For example, the City of Santa Monica, at only eight square miles, is geographically small, and their City Attorney advised them that it did not have to conduct a nexus study or

⁵ Pasadena, Santa Monica, West Hollywood, San Diego and San Jose

establish a nexus because art placed within the City limits can generally be easily enjoyed by City residents.

During the benchmarking exercise, staff from three California cities also indicated that in the majority of the cases, Developers elect to develop the art project themselves, versus pay the fee. However, this is not the case in Los Angeles. We reviewed the Department's internal database and found that private Developers in the City pay the fee in approximately 90% of the cases, as noted in the table below:

Arts Development Fee Project Type Comparison Since December 2006					
Project Type	# of Development Projects	# of Art Projects⁶	Total \$ Amount of 1%	Avg. \$ Amount	Median \$ Amount
Private Developer-Led	54	54	\$4,512,326	\$83,562	\$37,463
Private Developer Paid-In	428	32	\$7,703,308	\$17,998	\$8,860
Public Works Improvement Arts Projects⁷	59	59	\$11,160,567	\$192,424	\$37,200

Since 2006, the total construction costs for Developer-Led and Developer Paid-In projects that meet the Arts Development Fee requirements, is \$450 million and \$770 million, respectively. The comparative data is from December 2006 when the Department started tracking the Paid-In fees by development address, since prior to 2006 the Paid-In fees were used to support citywide art related projects and services and augmented departmental operations for one year.

While Developers opted to pay the fee much more often than lead their own project, the average amount of the Paid-In fee is much lower than the average amount spent on the Developer-Led projects. This indicates that the Developers that lead their own projects are generally those with larger construction projects. Developers of smaller projects may find it easier to pay the fee, rather than integrate the art in their relatively smaller design or plan. It would be useful for the City to solicit feedback from Developers regarding the art requirement when revising the related Ordinances.

Framework

In 2010, the Department issued the “Framework for Cultural Planning.” The Framework includes five key goals and eleven recommendations related to the City’s cultural environment. Two different recommendations for various stakeholders refer specifically to the City’s 1% for Art programs, which infers that the Department acknowledges that

⁶ One art project may include one or more of the following; a permanent art installation, a temporary art exhibition, a cultural performance or a cultural festival.

⁷ These projects include those initiated by the proprietary departments.

the current program is not operating effectively and there are opportunities for improvement. These include:

- ✓ ***Recommendation 2c - Directed to the Mayor and City Council***
Specific steps, including possible revisions to existing City ordinances, should be developed to better align the uses of PWIAP and private ADF program funds with the Framework's vision and to better support the artistic sector and community needs in all areas of the City.
- ✓ ***Recommendation 8c - Directed to the Department of Cultural Affairs and the Cultural Affairs Commission***
The Department, working in concert with the arts sector, should recommend specific steps and issue guidelines that codify the way PWIAP and ADF funds can be deployed to better align the uses of PWIAP and ADF program funds with this plans vision and to better support the artistic sector and community needs in all areas of the City.

While these appear to be public acknowledgement of the issues related to the 1% for Arts Development funds, Department management explained that the Framework was never formally adopted by the Mayor or City Council; therefore, the Department does not have the authority to enact it.

Inconsistent Allowable Uses

Both the Paid-In and Developer-Led Arts Development Fee programs appear to have the same objective, which is to mitigate the burden placed on the City's arts and culture infrastructure by the development and to ensure that the public can enjoy art and cultural services throughout the City. However, the programs are dictated by two different City governmental codes; and the allowable uses of the fee and credit are inconsistent. While the Developer-Led program includes specific examples of how the credit can be applied, the language for the Developer Paid-In program is vague.

For example, the Developer-Led program is codified in Los Angeles Administrative Code section 22.118, and includes the following under sub-section c:

- i. Performing arts: Theatre, dance, music and performance art.
- ii. Literary arts: Poetry readings and storytelling.
- iii. Media arts: Film and video, screenings and installations.
- iv. Education: Lectures, presentations and training in and about arts and culture.
- v. Special events: Parades, festivals and celebrations.
- vi. Similar services on culture and the arts as determined approved by the Cultural Affairs Department.

However, the allowable uses for the Developer Paid-In Fee program, as discussed in Los Angeles Municipal Code 91.107.4.6.5 does not include specific examples of programs or services, and simply states:

“Any cultural and artistic facilities, services and community amenities provided shall comply with the principles and standards set forth in the Cultural Master Plan when adopted.”

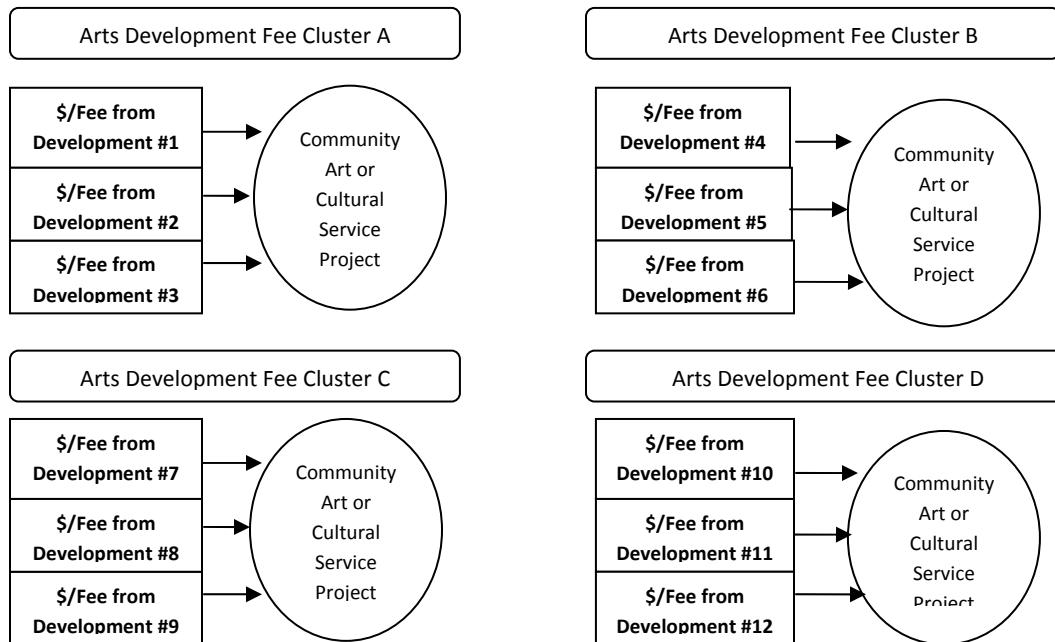
Although the Developer Paid-In and Developer-Led programs have the same overall objective, the specific services and programs for which the collected fees and credits allocated to Developers can be utilized are inconsistent.

Arts Development Fee Clusters

One option the Department developed for policy makers to consider are “art clusters,” which would entail grouping the Developer Paid-In fees that are collected from developments that are located within a specific geographic radius, and allow them to be consolidated and used for one larger, art or cultural project within that cluster. For example, the Department could utilize census tracts, Neighborhood Councils, or zip codes as the cluster boundaries, and use all of the funds collected within the cluster for an art project. The exact model would have to be reviewed in detail by the Department and the City Attorney.

A broader geographic radius defined by a “cluster” would allow for more flexibility, while also providing some assurance that the fees would be used within a reasonable distance from where the fee was collected. Further, since some projects generate smaller fees, clusters would allow the Department to achieve greater economies of scale by consolidating the fees to create one large project. Exhibit 1.2 is an illustrated example of the cluster model:

Exhibit 1.2
Potential Arts Development Fee Allocation Model



It is important to note that the primary objective of the Private Arts Development Fee Program is to ensure that the public can enjoy art and cultural services that might be displaced from the planned development and to mitigate the additional burden placed on the City's arts and culture infrastructure and facilities by the development's future employees.

This makes it imperative that City stakeholders develop a solution to address the issues related to the administration of the fees, so they can be put to use immediately. With improvements to the local economy, Developer activity could increase throughout the City, which would subsequently increase the Arts Development Fees even faster, providing both an opportunity to expand art and cultural services, and a challenge to spend it in accordance with all regulations.

Recommendations

Cultural Affairs Management should:

- 1. Solicit feedback from Developers to understand how they view the City's Arts Development Fee program and consider their input when revising any related ordinances.**

Cultural Affairs Management and City Council should:

- 2. Consider reviewing and resolving any discrepancies in the relevant sections of the Administrative Code (Paid-In Fees) and the Municipal Code (Developer-Led Credits) which dictate the services and programs for which the fees and credits can be utilized.**
- 3. Consider developing a “Cluster” Model, which would allow the Department to group Arts Development Fees that fall within a reasonable distance from the development site and administer them in a consolidated manner.**

Cultural Affairs Management should:

- 4. Determine, in conjunction with the City Attorney, how to address the high cash balance in Fund #516 so that the accumulated Arts Development Fees and interest are used to fund publicly accessible art projects and/or cultural programs in a more timely manner.**
- 5. Complete and submit the required quarterly and annual reports to City Council which detail the activities in Fund #516 to allow for a timely discussion among policy makers to determine how any unused Arts Development Fees should be reallocated.**

Finding No. 2: Since 1991, Fund #516 has earned \$2 million in interest, but it is unclear how much has been spent and the Department does not have an established methodology to attribute earned interest to specific projects.

Section 5.346 (b) of the Los Angeles Administrative Code states that, “all interest and earnings of the Fund shall accrue to the Fund,” and references State code 66006, which more specifically dictates that “any interest income earned by monies in the capital facilities account or Fund shall also be deposited in that account or Fund and shall be expended only for the purpose for which the fee was originally collected.” Based on the State Code, it appears that the interest should be used or spent on the same projects that are associated with the original development fee. As discussed in Finding #1, current geographic restrictions have limited the Department’s ability to create art projects with the original development fees, and by default, the earned interest associated with these unspent funds, is also constrained by the City Attorney’s advice.

From 1991 through March 31, 2013, the Fund earned almost \$2 million in interest. During our review, the Department was unable to provide information regarding attributing interest to art projects. Current staff are in the process of reconciling the Fund.

Interest Accrued Each Year in Arts Development Fund #516												
1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	
\$0	\$30,113	\$87,896	\$49,060	\$40,656	\$71,778	\$82,140	\$66,771	\$58,004	\$82,463	\$111,129	\$135,277	
2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013		TOTAL
\$143,561	\$61,152	\$17,804	\$48,281	\$73,024	\$158,865	\$172,367	\$129,240	\$113,328	\$121,617	\$110,356	\$1,964,882	

Near the end of our audit, the Department reported that it estimates that approximately \$1.1 million in interest has not been attributed to specific development projects. The Department’s estimate of \$1.1 million appears reasonable. For example, based on a review of FMS data, we believe that the Fund’s cash balance currently includes at least \$800,000 in accumulated interest. This represents interest accrued since July 1, 2007 when the Department started maintaining individual development project accounts. Accordingly, the Department has not established a method to attribute interest earnings to the individual development project accounts.

Proper accounting requires that the Department establish a method to attribute interest in a manner which is consistent with the Administrative Code, as discussed in Finding #1. The methodology should be flexible enough to accommodate any future change to the Administrative Code.

Recommendations

Cultural Affairs Management should:

- 6. In consultation with the Controller's Office, immediately establish a method to attribute interest earnings that is consistent with the Administrative Code.**
- 7. Consider a method which will allow the interest from multiple sites to be leveraged so larger art projects can be made available throughout the City.**
- 8. Establish adequate controls to ensure that interest credited to Fund #516 is attributed in a timely manner, in accordance with the established methodology.**

Finding No. 3: The Temporary Public Arts Pilot Program was a way to both address the restrictions on the Developer Paid-In Fees and mitigate a budget shortfall. This should be considered as a way to partially fund the Department's Grant program in the future.

In 2008, the Department issued a Request for Qualifications (RFQ) for Artists, to begin a Temporary Public Arts Pilot Program which would be funded with a portion of the Developer Paid-In Arts Development Fees. However, in 2009, the first round of projects was rejected by the City Attorney's Office on the grounds that temporary projects were not allowable. According to the Department, this delayed the launch of the Pilot Program by over one year and the program finally launched in 2011 after a series of meetings with the former Mayor's Arts Deputy and the City Attorney. The Department indicated this also presented an opportunity to restart the temporary public art program as a safeguard to the budget cuts that were occurring during this time.

The first component, called the "Expanded Cultural Arts Program," started with the Department's Grants Division generating a list of all of the organizations that received grants from the Department, which totaled over 200 organizations. The organizations on the list were then matched to as many development fee addresses as possible. The Department was able to match 20 organizations to sites which met the one-block radius restriction, and thus were all approved by the City Attorney. The second component, called the "Expanded COLA Program", involved distributing the development fees associated with one large development. The Department provided funding to 12 artists through the City of L.A.'s Individual Artist Fellowship (COLA), which is usually funded outside of the 1% for Art Program, by Transit Occupancy Tax funding. The artists worked on pieces and/or performances that were temporarily displayed at a park across the street from the development.

While the Department attempted to address the restrictions placed on the fees, the Pilot Program enabled the Department to supplement an existing Department grant program when there was a budget shortfall⁸, and was not a formal solution to the current programmatic issues of the Developer Paid-In Program. Generally, Pilot Programs are implemented on a limited basis and quickly evaluated to determine whether or not they should be continued and expanded to meet the organization's objectives. However, this Pilot Program, which began in 2011, has not been formally evaluated by the Department to determine whether it should develop formal guidelines and continue administering the Arts Development Fees using this approach. The Department indicated the final reports for the last five projects were submitted to the Department in early 2013 and it plans to evaluate the program shortly.

If the Department believes that the Pilot Program is successful, it should consider supplementing the line item in their annual budget for the grant program with a portion of the collected Arts Development Fees. This would have the effect of freeing up other funding sources, such as the General Fund, that are currently dedicated to that program.

Recommendations

Cultural Affairs Management should:

- 9. Evaluate the results of the Pilot Program.**
- 10. If the Pilot Program is deemed successful, work with the CAO to consider allocating a portion of the Paid-In Development Fees to the Grants Administration Division's annual budget to provide funding to organizations that provide services within the (revised) allowed radius of the development generating the fee.**

Finding No. 4: The methodology used to calculate the Arts Development Fee, which is to be adjusted annually based on the Consumer Price Index, has not been updated since the program's inception in 1991.

The "Paid-In" fee requires the Developer to pay a fee equal to one percent of the valuation of the project designated on the building permit or an amount per gross square foot of any structure authorized by the permit, **whichever is lower**, as determined by DBS. As specified in the Municipal Code, the Arts Development Fees are currently calculated as follows:

- ✓ Office or Research & Development Bldg -\$1.57/sq ft
- ✓ Retail Establishment - \$1.31/sq ft

⁸ According to Department management, sizable cuts were proposed to the Grants program in 2011.

- ✓ Manufacturing Bldg - \$0.51/sq ft
- ✓ Warehouse Bldg - \$0.39/sq ft
- ✓ Hotel Bldg - \$0.52/sq ft

For example, if the valuation of a 5,000 square foot retail establishment is \$600,000, the Arts Development Fee would be \$6,000 ($\$600,000 \times 1\% = \$6,000$) because in this example, the 1% amount is less than the calculated amount of \$6,550 (5,000 sq. ft. $\times \$1.31$).

Per Municipal Code section 91.107.4.6.2., the Department is required to revise the Arts Development Fees annually by an amount equal to the Consumer Price Index for Los Angeles as published by the United States Department of Labor. Revised amounts should then be submitted to Council for adoption by Ordinance. However, we found that the dollar per square foot amounts have not been revised since the Ordinance was originally adopted in 1992.

The Nexus Study conducted in 1991 included the methodology used to arrive at these amounts, which considers the Building use/type, the expected occupancy of the building, and the dollar value of the “arts burden”⁹ imposed by the addition of each new person in the workforce throughout the City. Specifically, the study estimated the following:

1. The municipal allocation for art and cultural facilities, services, and community amenities per person, per year in the City of Los Angeles was \$12.48.
2. The number of new people who will work in a commercial or industrial development based on an adjusted standard number of square feet per employee.

Office - 250 sq. ft. / employee
Research and Development - 250 sq. ft. / employee
Manufacturing - 765 sq. ft. / employee
Warehouse and Distribution - 1,000 sq. ft. / employee
Retail - 300 sq. ft. / employee
Hotel - 750 sq. ft. / employee

3. The useful life of commercial and industrial developments in the City was 31.5 years.

Based on these amounts, the study concluded that the City would be justified in using a rate as high as 3.74% of the permit valuation. However, the City Council expressed its intent to limit it to 1%. Since the 1% was selected, the study noted that “because the justified fee for all building types except hotels exceeds the fee caps, the Department will only have to calculate 1% of the permit valuation to obtain the fee amount.” This

⁹ Per capita amount the City spends on Arts and Cultural Services.

was reiterated by a DBS representative, who explained that the 1% of permit valuation calculation appears to be applied the vast majority of the time.

We noted that every three years, DBS is responsible for revising the “building valuation” table used to determine the construction costs of new developments. For example, if a Developer wants to construct a new building and the primary material is wood, part of the permit cost will be based on the market price of wood (as maintained in the table), multiplied by the estimated square footage of the building. Since DBS revises these prices every three years, it is possible that this minimizes the effect of the Department failing to adjust the amounts used to calculate the Arts Development Fee. However, without a detailed analysis, the impact on the Arts Development Fees is unknown. Since more than 20 years have passed since the Arts Development Fee Ordinance was initially adopted, the Department should review both the CPI and the 1% to ensure the City is collecting the appropriate amount of Arts Development Fees. Further, we found a 2007 CAO report which recommended that the Department “review the estimated rates and adjust the Fee in accordance with the Municipal Code.”

According to data maintained by the Bureau of Labor Statistics, the CPI¹⁰ in Los Angeles increased approximately 58% from 1992 through 2012. By not revising the rates according to the CPI, the City could have lost as much as 58% in fee revenue in some cases. At a minimum, since it is a relatively easy calculation, the Department should follow the code and provide the updated numbers to City Council for consideration.

Recommendations

Cultural Affairs Management should:

- 11. Comply with the Municipal Code and provide the updated fee rates to City Council for consideration.**
- 12. Work with the City Administrative Officer and City Council to evaluate whether the 1% cap should be reassessed.**

Finding No. 5: The Developer Paid-In Arts Development Fee database does not ensure consistent reporting.

The “Paid In” Arts Development Fees projects are tracked in an Access database, which has been used since 2007. The database is primarily used for maintaining Developer information, the status of the project and some correspondence notes. Staff can generate reports from the system; however, during the audit we found that some fields are redundant, which decreases the reliability or consistency of the reports. For

¹⁰ Consumer Price Index for Urban Customers - Area includes Los Angeles, Riverside and Orange County California

example, there are some instances in which a fee must be refunded to a Developer, but there are four different status options for a refunded fee:

- ✓ Refund
- ✓ Refunded
- ✓ Refunded School
- ✓ School Refunded

Therefore, if staff runs a report and only selects the “Refund” option, it would not accurately reflect the number of Developers or total amount of fees that have been refunded. Since generating the reports requires staff to select the options desired, there is a high risk that the database may generate reports with errors or missing information.

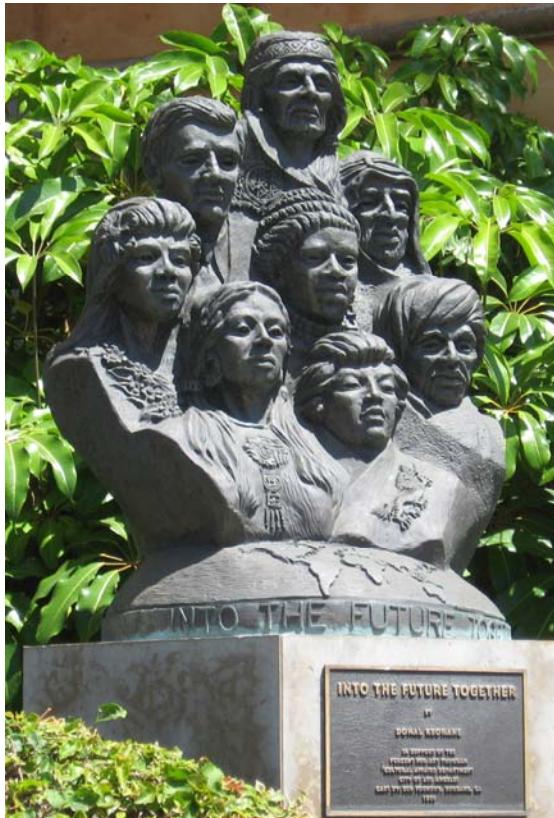
The Department does not have dedicated full-time IT staff who can provide technical support for the database, and fields may have been created in an ad-hoc manner.

Recommendation

13. **Cultural Affairs Management should review the fields in the Developer Paid-In Development database, and work with ITA to modify and eliminate redundant options in order to simplify reporting.**

Section II: Arts Development Fee Developer-Led Program

Rather than paying the 1% for art fee to the City, a Developer has the option of designing and implementing an artistic or cultural amenity associated with their development site at a value equal to or greater than the dollar amount of the Arts Development Fee they would otherwise pay. These are informally referred to as Developer-Led or “In-Lieu” projects. For these projects, the Developer is responsible for managing all aspects of the associated art project, including artist selection and payment, and ensuring the project is completed in a timely manner. Generally, this option is selected by Developers that want to maintain a specific aesthetic in their building or already have a specific project in mind.



11800 WILSHIRE BLVD
SCULPTURE, “INTO THE FUTURE TOGETHER”
ADF 1% = \$18,000

Certificate of Deposit (CD)

- According to Department staff, a Certificate of Deposit is generally used by Developers that have more experience with the process and plan to complete the construction project within a short timeframe. A CD also requires the Developer to have a healthy amount of cash on-hand, because the Developer must purchase the CD, and also spend the equivalent amount on the art project. Once the project is complete, the Department would release the CD and the Developer would get the funds back. Decreasing the amount of a CD is more difficult than a Letter of Credit, as there are penalties when the CD is drawn down within a short timeframe (90 days). Therefore, these instruments do not easily accommodate Developers who seek to reduce the collateralized amount as they progress towards fulfilling the arts requirement. CDs also accrue interest, which is paid to the Developer when the project is satisfactorily completed. At the time of audit

fieldwork, the Certificate of Deposits for active projects totaled approximately \$500,000.

Letter of Credit (LOC)

- A Letter of Credit is a written guarantee from the Developer's bank that the Developer is in good financial standing and the bank agrees to extend that credit as payment to the City if the Developer does not complete the art component of the project. When these are used, the Developer does not have to actually use or deposit funds with their bank. Per Departmental staff, LOC's are generally used for projects with larger budgets, because it is more difficult for the Developer to pay out the amount to purchase a CD. The Developer can "draw down" or decrease the amounts in the letters of credit fairly easily, as the project progresses. For example, if the full amount of the obligation is \$100,000, and they provide proof to the Department that they paid an artist \$20,000 towards their obligation, the Department can allow the Developer to decrease the balance of the LOC to \$80,000. At the time of audit fieldwork, the Letters of Credit for active projects totaled approximately \$1 million.

A standard term of agreement form, developed by the Department is attached to each financial collateral instrument provided by the Developers. The form references the amount and type of the financial collateral document, and includes language related to the City's right to redeem the amount if the program conditions are not met.

An original copy of the agreement signed by the Developer and the Department's General Manager along with the selected collateral instrument is maintained in a safe at the Department. If an art project does not materialize or comply with the agreement, the City may redeem the CD or the Letter of Credit.

Finding No. 6: The Department does not always enforce the project completion date for Developer-Led projects.

We reviewed the active projects in the Department's database of Developer-Led Projects and noted the anticipated completion date and the expiration date of the financial collateral instrument to determine if the projects were being completed timely. All of the projects have an anticipated completion date, but only some of the financial collateral instruments included an expiration date; however, some had automatic renewal clauses. In these instances, there is language in the financial instrument that states that it will automatically renew one year after the initiating date.

We found a few projects that were still active even though more than five years had passed since the expected completion date.

Completion Dates

Three Developer-Led projects with target completion dates of October 2007 are still active almost six years later. We confirmed that the expected art or cultural project has still not been completed, even though the Developer-Led project database included staff notes indicating that the construction of the development was complete. Staff indicated that all three of these projects, which total \$21,000, are associated with the same Developer and they are working with them to complete the art project soon or they will redeem the certificates of deposit.



It is understood that construction projects can take longer to complete than expected due to extenuating circumstances and it may be reasonable for the

Department to work with the Developer to inquire and document any issues that may extend an expected completion date of the art project. However, in this case, six years is excessive; the Department should have set and enforced a hard deadline for completion of the art projects, and if it was not met, the CDs should have been redeemed. If the Department does not enforce program guidelines, there is a risk that future Developers will disregard the art requirement.

The current functionality of the project management database requires staff to proactively generate a report which lists the project completion dates and the expiration dates. This would be a reasonable routine procedure to implement to ensure the Department is adequately monitoring and enforcing the project deadlines.

Recommendation

- 14. On a monthly basis, Cultural Affairs Management should generate a report of active projects which lists the anticipated completion dates and the financial collateral instrument expiration dates to ensure the deadlines have not passed, and notify Developers with approaching deadlines to ensure program requirements are enforced.**

Finding No. 7: The City Attorney does not approve the Department's agreements for Developer-Led projects and the format and type of financial collateral instruments provided is inconsistent, which may limit the City's protection.

The standard terms of agreement form, which accompanies each financial collateral instrument, is signed only by the Developer and the Department's General Manager. Generally, any financial agreement that a City Department enters into should be reviewed and signed by the City Attorney to ensure that the City is adequately protected, especially in cases where the Department may need to redeem the collateral instrument and withstand any challenge to the agreement. The Department indicated that the City Attorney's Office reviewed and approved a template several years ago. However, staff was unable to provide documented evidence of the approval.

We also found that the formats of the financial collateral instruments provided to the Department are inconsistent. While they are labeled Certificates of Deposits or Letters of Credit, the manner in which they are addressed or completed varies. For example, one Letter of Credit was addressed directly to the City of Los Angeles, not the Department. There was another certificate of deposit that did not even have the City of Los Angeles or the Department as the listed beneficiary. With such inconsistencies among the collateral instruments, and without formal legal review and approval of the agreements, the City's ability to redeem the collateral is questionable.

Recommendations

Cultural Affairs Management should:

- 15. a) Obtain formal approval from the City Attorney for a standard agreement template that is consistent with City contracts, and determine the approval process for the individual agreements and related financial collateral instruments.**
- b) Consider collecting a financial collateral instrument from the Developer, only when they fail to complete the art component. The certificate of occupancy should be withheld until either the art component is completed or until the Developer has provided the City with an acceptable financial collateral instrument.**

- 16. Instruct the Developers to designate the City of Los Angeles, Department of Cultural Affairs, as the beneficiary of the selected financial collateral document.**

Finding No. 8: The Developer-Led Arts Development Fee database does not ensure consistent and reliable reporting.

Similar to the Paid-In projects, the Developer-Led projects are tracked in an Access database which has also been used since 2007. The database is primarily used for maintaining Developer information, the status of the project and some correspondence notes. Staff can also generate reports from the system; however, during the audit we found that some fields are redundant, thereby decreasing the reliability or consistency of any reports that may be generated from the system. Specifically, we found a total of 26 project “status” options. While it is possible that there are multiple statuses for associated projects, projects are generally either active or closed, so this excessive number of statuses is questionable. We also found two options available to reference a cancelled project, i.e. “cancelled” and “canceled.” Since generating the reports requires staff to select the specific options desired through a query, there is a high risk that reports could be produced with errors or missing information. The Department does not have dedicated, full-time IT staff who can provide technical support for the database and these excessive fields may have been created in an ad-hoc manner.

Recommendation

- 17. Cultural Affairs Management should review the fields in the Developer-Led database to limit excessive options and work with ITA to modify and eliminate redundant options.**

Section III: Public Works Improvement Arts Program

We also reviewed a sample of project files for the PWIAP. We found that the Department generally had good processes in place to administer the program and the files had sufficient documentation to demonstrate compliance. However, the Department needs to improve the planning and reporting process for planned expenditures from the PWIAP.



CYPRESS PARK BRANCH - LOS ANGELES PUBLIC LIBRARY
PAINTED MURAL (PARTIAL IN PHOTO)
PWIAP 1% = \$20,000

Finding No. 9: The Department does not submit an annual plan for expenditures for the Public Works Improvement Art Program.

Sec. 19.85.3 of the Administrative Code states:

*"The Cultural Affairs Department **shall prepare an annual plan for expenditures from the Trust Fund** in accordance with the guidelines adopted pursuant to 19.85.5. The plan shall be subject to review and recommendation by the Board of Cultural Affairs Commissioners and subject to the approval of both the Mayor and City Council."*

Departmental management indicated that when the Ordinance was first written in 1988, the total 1% in PWIAP funds for each project was transferred to the Department upon City Council approval. The Department then managed the planned expenditures for each project, including charging the allowable amounts related to their administrative oversight, and this was the accepted process for meeting the Administrative Code requirements. However, the Department has not had direct management and control over PWIAP funds since at least 1996, when large-scale projects were financed through construction bonds and regulations prohibited the transfer of allocated PWIAP funds;

and other large projects were initiated with multiple funding sources, making actual transfers infeasible.

The Arts and Cultural Facilities and Services Trust Fund (Fund #480) no longer serves as the repository for the total PWIAP fees; however, the Department is still required to ensure appropriate oversight over the PWIAP, and prepare an annual plan for related expenditures that is subject to review and approval of policymakers.

The Department does not submit an annual plan for PWIAP funding; rather, it submits individual project plans to their Commission for review and approval. As larger public projects typically take several years to complete, the Department reports their status to the Commission at regular monthly commission meetings, including progress made toward completion.

The specific administrative requirement calls for the Department to *“prepare an annual plan for expenditures from the Trust Fund,”* which would inform policymakers of the anticipated use of resources for upcoming projects and the progress made on those that are in development. Though the Department does not directly receive or expend the total amount of art funding for the associated public works projects, it remains responsible for program oversight to ensure appropriate planning and implementation of these projects.

In order to comply with the Administrative Code and ensure that funds committed to the PWIAP is planned and expended in an effective manner, the Department should submit an annual plan to City policy makers. Since the Department already presents the relevant PWIAP project information for ongoing projects to the Commission on a monthly basis, and it generally has an idea of anticipated projects, it should be able to summarize this information into an annual plan, which can then be submitted to City Council for formal approval. This annual plan can be viewed as a tool to ensure transparency of the PWIAP projects and related Department activities paid through this program, and help the Department plan for future allocation of resources.

Recommendation

- 18. Cultural Affairs Management should submit an annual plan for the use of all PWIAP funds to the Cultural Affairs Commission, Mayor and Council for review and approval.**

Section IV: Additional Observation

Finding No. 10: There is a risk that the 1% set aside for the Developer-Led projects may be used to finance construction costs for projects that integrate the art component directly into the development project.

Some of the Developers who select the Developer-Led option and manage the art project themselves; incorporate the art component directly into their development site. For example, one Developer included an artistic/ornamental design in the automatic entry gate surrounding their development. This approach can also be found within the PWIAP projects. For example, one of the City's animal shelters includes art glass windows on the outside of the shelter walls. In both of these examples, the art is integrated into a functional and required element of the development, as opposed to a stand-alone piece, such as a sculpture placed in the building's lobby or courtyard.



**DEVELOPER-LED PROJECT – ORNATE GATE
12157 W. BRANFORD
ARTS DEVELOPMENT FEE \$ 10,715**

Developer –Led

In an effort to prevent Developers from applying the fee primarily towards construction costs for projects that integrate the art directly into the development, Administrative Code section 22.118 (2) (g) specifically states that the fee amount **cannot** be used on the following:

- ✓ Directional elements such as super graphics, signage, or color coding except where these elements are integral parts of the original work of art.
- ✓ Art objects which are mass produced of standard design such as playground equipment, fountains or statuary objects.
- ✓ Reproductions, by mechanical or other means, of original works of art, except in cases of film, video, photography, printmaking or other media arts.

- ✓ ***Decorative, ornamental, or functional elements which are designed by the building architect as opposed to an artist commissioned for this design enhancement purpose.***
- ✓ Landscape architecture and landscape gardening except where these elements are designed by the artist and/or are an integral part of the work of art by the artist.
- ✓ Services or utilities necessary to operate or maintain the artwork over time.

Departmental management explained that at the beginning of a Developer-Led project, Developers are required to provide an art component budget, which is reviewed and approved by staff. When the project is completed, the Developer must also provide detailed accounting records of expenses associated with the final artwork before the financial security is released. Management added that in almost every case, the Developer spends more than the 1% for the art requirement for the integrated art projects.

Despite these guidelines, there is a risk that the 1% arts fee could be used to finance some of the incremental construction costs that are exclusive to the development/project itself. For instance, in the gate example previously discussed, the Developer may receive a credit of \$10,000 in lieu of paying the fee, and submit an art plan to incorporate the artistic design into the metal gate surrounding the development. Since the Developer planned to construct a gate regardless of an art component, there is a possibility that \$10,000 is not allocated to additional special metals or the artist fees; rather, some of the \$10,000 may be spent on the metal that will be used to construct the functional part of the gate, or parts not specific to the art component.

While the Department reviews the art plan and final expense report, the Department's guidelines and review process for the Developer-Led projects do not explicitly include a comparison or calculation of the art project cost, as an incremental cost component over and above the costs of the functional construction.

PWIAP

Since the PWIAP art project budgets are generally much larger, the budgets and plans are vetted by several stakeholders, including Department staff, the Public Art Committee, the Cultural Affairs Commission, the lead agency, the CAO, and the Bond Committee (when applicable). The Department indicated that these reviews should help mitigate the risk of financing construction costs for the PWIAP projects. However, the review process for the PWIAP projects also does not explicitly include a comparison or calculation of the art project cost against the total development construction costs.

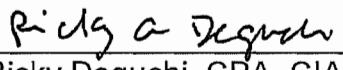
Recommendation

19. Cultural Affairs Management should revise the Developer-Led and PWIAP guidelines to require staff to compare the art component plan against the development construction costs to ensure it will only be used for materials and labor exclusively for the project, and not to finance incremental construction costs of the development/project.

Respectfully submitted,



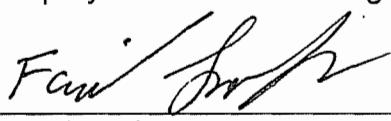
Sydia Reese
Internal Auditor III



Ricky Deguchi, CPA, CIA, CISA
Chief Internal Auditor



Siri Khalsa, CPA
Deputy Director of Auditing



Farid Saffar, CPA
Director of Auditing

September 12, 2013

APPENDIX I
OFFICE OF THE CONTROLLER

Ranking of Recommendations

Finding No.	Description of Finding	Ranking Code	Recommendations
Section I: Arts Development Fee Developer Paid-In Program			
1.	The Department has spent a limited amount on Developer Paid-In projects since 2008 due to tight restrictions placed on the use of the Developer Paid-In fees. This resulted in \$10 million accumulating in Fund #516, of which the Department has not developed spending plans for approximately \$7.5 million.	1	<p>1. Cultural Affairs Management should solicit feedback from Developers to understand how they view the City's Arts Development Fee program and consider their input when revising any related ordinances.</p>
		1	<p>2. Cultural Affairs Management and City Council should consider reviewing and resolving any discrepancies in the relevant sections of the Administrative Code (Paid-In Fees) and the Municipal Code (Developer-Led Credits) which dictate the services and programs for which the fees and credits can be utilized.</p>
		1	<p>3. Cultural Affairs Management and City Council should consider developing a "Cluster" Model, which would allow the Department to group Arts Development Fees that fall within a reasonable distance from the development site and administer them in a consolidated manner.</p>
		1	<p>4. Cultural Affairs Management should determine, in conjunction with the City Attorney, how to address the high cash balance in Fund #516 so that the accumulated Arts Development Fees and interest are used to fund publicly accessible art projects and/or cultural programs in a more timely manner.</p>

APPENDIX I
OFFICE OF THE CONTROLLER

Finding No.	Description of Finding	Ranking Code	Recommendations
1.	<p>The Department has spent a limited amount on Developer Paid-In projects since 2008 due to tight restrictions placed on the use of the Developer Paid-In fees. This resulted in \$10 million accumulating in Fund #516, of which the Department has not developed spending plans for approximately \$7.5 million.</p>	1	<p>5. Cultural Affairs Management should complete and submit the required quarterly and annual reports to City Council which detail the activities in Fund #516 to allow for a timely discussion among policy makers to determine how any unused Arts Development Fees should be reallocated.</p>
2.	<p>Since 1991, Fund #516 has earned \$2 million in interest, but it is unclear how much has been spent and the Department does not have an established methodology to attribute earned interest to specific projects.</p>	2	<p>6. Cultural Affairs Management should, in consultation with the Controller's Office, immediately establish a method to attribute interest earnings that is consistent with the Administrative Code.</p>
		2	<p>7. Cultural Affairs Management should consider a method which will allow the interest from multiple sites to be leveraged so larger art projects can be made available throughout the City.</p>
		2	<p>8. Cultural Affairs Management should establish adequate controls to ensure that interest credited to Fund #516 is attributed in a timely manner, in accordance with the established methodology.</p>

APPENDIX I
OFFICE OF THE CONTROLLER

Finding No.	Description of Finding	Ranking Code	Recommendations
3.	<p>The Temporary Public Arts Pilot Program was a way to both address the restrictions on the Developer Paid-In Fees and mitigate a budget shortfall. This should be considered as a way to partially fund the Department's Grant program in the future.</p>	1	<p>9. Cultural Affairs Management should evaluate the results of the Pilot Program.</p>
		2	<p>10. If the Pilot Program is deemed successful, Cultural Affairs Management should work with the CAO to consider allocating a portion of the Paid-In Development Fees to the Grants Administration Division's annual budget to provide funding to organizations that provide services within the (revised) allowed radius of the development generating the fee.</p>
4.	<p>The methodology used to calculate the Arts Development Fee, which is to be adjusted annually based on the Consumer Price Index, has not been updated since the program's inception in 1991.</p>	2	<p>11. Cultural Affairs Management should comply with the Municipal Code and provide the updated fee rates to City Council for consideration.</p>
		2	<p>12. Cultural Affairs Management should work with the City Administrative Officer and City Council to evaluate whether the 1% cap should be reassessed.</p>

APPENDIX I
OFFICE OF THE CONTROLLER

Finding No.	Description of Finding	Ranking Code	Recommendations
5.	The Developer Paid-In Arts Development Fee database does not ensure consistent reporting.	2	13. Cultural Affairs Management should review the fields in the Developer Paid-In Development database, and work with ITA to modify and eliminate redundant options in order to simplify reporting.
	SECTION II: ARTS DEVELOPMENT FEE DEVELOPER-LED PROGRAM		
6.	The Department does not always enforce the project completion date for Developer-Led projects.	2	14. On a monthly basis, Cultural Affairs Management should generate a report of active projects which lists the anticipated completion dates and the financial collateral instrument expiration dates to ensure the deadlines have not passed, and notify Developers with approaching deadlines to ensure program requirements are enforced.
7.	The City Attorney does not approve the Department's agreements for Developer-Led projects and the format and type of financial collateral instruments provided is inconsistent, which may limit the City's protection.	1	<p>Cultural Affairs Management should:</p> <p>15. a) Obtain formal approval from the City Attorney for a standard agreement template that is consistent with City contracts, and determine the approval process for the individual agreements and related financial collateral instruments.</p> <p>b) Consider collecting a financial collateral instrument from the Developer, only when they fail to complete the art component. The certificate of occupancy should be withheld until either the art component is completed or until the Developer has provided the City with an acceptable financial collateral instrument.</p>

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Finding No.	Description of Finding	Ranking Code	Recommendations
7.	The City Attorney does not approve the Department's agreements for Developer-Led projects and the format and type of financial collateral instruments provided is inconsistent, which may limit the City's protection.	1	16. Cultural Affairs Management should instruct the Developers to designate the City of Los Angeles, Department of Cultural Affairs, as the owner/beneficiary of the selected financial collateral document.
8.	The Developer-Led Arts Development Fee database does not ensure consistent and reliable reporting.	2	17. Cultural Affairs Management should review the fields in the Developer-Led database to limit excessive options and work with ITA to modify and eliminate redundant options.
SECTION III: PUBLIC WORKS IMPROVEMENT PROGRAM			
9.	The Department does not submit an annual plan for expenditures for the Public Works Improvement Art Program.	2	18. Cultural Affairs Management should submit an annual plan for the use of all PWIAP funds to the Cultural Affairs Commission, Mayor and Council for review and approval.
SECTION IV: OTHER OBSERVATIONS			
10.	There is a risk that the 1% set aside for the Developer-Led projects may be used to finance construction costs for projects that integrate the art component directly into the development project.	2	19. Cultural Affairs Management should revise the Developer-Led and PWIAP guidelines to require staff to compare the art component plan against the development construction costs to ensure it will only be used for materials and labor exclusively for the project, and not to finance incremental construction costs of the development/project.

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Description of Recommendation Ranking Codes

1- Urgent-The recommendation pertains to a serious or materially significant audit finding or control weakness. Due to the seriousness or significance of the matter, immediate management attention and appropriate corrective action is warranted.

2- Necessary- The recommendation pertains to a moderately significant or potentially serious audit finding or control weakness. Reasonably prompt corrective action should be taken by management to address the matter. The recommendation should be implemented within six months.

3- Desirable- The recommendation pertains to an audit finding or control weakness of relatively minor significance or concern. The timing of any corrective action is left to management's discretion.

N/A- Not Applicable