

March 13, 2009

Ms. Debra K. Davenport, CPA  
Auditor General  
State of Arizona  
2910 N 44<sup>th</sup> Street, Suite 410  
Phoenix AZ 85018

RE: 2008 Performance Auditor of the Arizona Sports and Tourism Authority

Dear Auditor General Davenport:

On behalf of the Board of Directors and staff of the Arizona Sports and Tourism Authority we appreciate the opportunity to respond to the 2008 Performance Audit of the Authority.

Since the Authority's inception in late 2000, this is the second performance audit of the Authority. The first occurred a little more than two years after our inception and at a time when the University of Phoenix Stadium was less than eight months under construction. This second performance audit comes at a time when the stadium has been open for operations for two+ years and we have held hundreds of events some of which have showcased the stadium, the Valley of the Sun and Arizona on a worldwide stage.

We are pleased with the outcome of the performance audit and the recommendations. The Authority has agreed with each of your findings and will implement their related recommendations over the coming months. We believe that your findings will continue to enhance the diverse set of operations and objectives required of the Authority by Arizona Revised Statute.

Our single, biggest obstacle to overcome is the same one that most, if not all, local, county, state and national governments and public/private organizations are facing – the economic crisis that has plagued our nation since late 2007. The majority of our revenue sources, approximately 90%, come from a variety of sales taxes, income taxes and car rental surcharges. The Authority is feeling the impact of this economic downturn which has been further aggravated by several legislative changes to our enabling legislation – the first was moving the funding for the Authority's operating budget in 2002 (including the stadium's operations) from the fourth to the final position in the flow of funds. The second was the elimination of the statutory minimum from our NFL income tax revenue source in 2007.

The elimination of the NFL income tax statutory minimum was based upon a recommendation made by the Auditor General's office during the first performance audit of the Authority. In that report, the Auditor General noted on page 28 that removal of the statutory minimum "...could

*potentially affect TSA's ability to meet its funding obligations. This could include TSA's ability to establish and fund required reserves for operations and repairs, and other long-term costs associated with the multipurpose facility. Reduction in or elimination of the additional General Fund monies for TSA could also affect its ability to adequately fund current operations."* What was forecasted in that first performance audit has become reality. The impact of the elimination of the statutory minimum on the Authority's sources of revenues for fiscal years 2008 and 2009 is more than \$3.24 million. While the operating deficits for the Authority are projected to be greater than this funding shortfall amount, this shortfall, combined with the estimated \$4.8 million impact of the 2002 legislative change, further exacerbates the financial obstacles that the Authority must overcome now and into the future.

The Authority will be working diligently over the coming months to implement the recommendations per our responses. Thank you again for this opportunity to respond to this performance audit report.

Sincerely,  
Tom Sadler  
President/CEO

cc: Jerry Walker, Chairman, Arizona Sports and Tourism Authority  
Board of Directors, Arizona Sports and Tourism Authority

Enclosure

Arizona Sports and Tourism Authority  
Summary Response to Findings and Recommendations – 2008 Performance Audit

FINDING 1

Authority should continue to address its financial situation

Recommendation 1.1

The Authority should revise its cash flow projections to incorporate capital repair and replacement costs and to reflect NFL income tax revenues at historical growth rates.

Authority Response

The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Recommendation 1.2

The Authority and its Board of Directors should continue to take steps to address its financial shortfall by increasing revenues and/or decreasing expenses. In doing so, the Authority should study the various options available to increase facility revenues and decrease facility expenses to address its projected deficits and fund its required reserve accounts.

Authority Response

The finding of the Auditor General is agreed to and the audit recommendation is currently in the process of being implemented with additional steps being identified for consideration for implementation.

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FINDING 2

Authority should enhance its oversight of the facility manager

Recommendation 2.1

The Authority should continue with its plans to review its incentive fee structure and revise its management agreement to include an incentive fee structure based on the performance of the facility manager, such as whether the facility manager increased revenues or reduced operating expenses. The Authority should also ensure that any changes it makes to the management fee structure conform to U. S. Internal Revenue Service regulations.

Authority Response

The finding of the Auditor General is agreed to and the audit recommendation will be implemented within the IRS guidelines Applicable to Management Contracts Involving Use of Bond-Financed Facilities.

Recommendation 2.2

The Authority should develop and implement a formal contract-monitoring plan detailing the activities that its staff will perform to adequately monitor the facility manager's performance in several key areas, such as the facility manager's financial activities, event settlements, and preventative maintenance.

Authority Response

The finding of the Auditor General is agreed to and the audit recommendation will be implemented with the understanding that the Authority has been and continues to monitor the financial activities and the preventative maintenance responsibilities of the facility manager.

Recommendation 2.3

The Authority should ensure that the facility manager establishes a written agreement with the Arizona Cardinals for box office services.

Authority Response

The finding of the Auditor General is agreed to and the audit recommendation will be implemented with the understanding that the Authority's facility manager has been operating under a documented, but unexecuted agreement related to box office services with the Arizona Cardinals.

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FINDING 3

Minor improvements needed to better fulfill mission

Recommendation 3.1

The Authority should update its written YAS policies and procedures to integrate selection criteria, which are now incorporated into application materials, and to eliminate the outside committee review of the YAS grant applications, which no longer occurs.

Authority Response

The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Arizona Sports and Tourism Authority  
Response to Findings and Recommendations of the Office of the Auditor General

FINDING 1 - Authority should continue to address its financial situation

The Authority has been long aware of its financial situation since part way through fiscal year 2008 when revenues were consistently coming in lower than our forecast. As we entered into early calendar year 2008 and began our budgeting and forecasting process for fiscal year 2009 it became readily evident that there would a protracted period of time, possibly several years or more, where revenues would be significantly lower than our long-term growth rates had anticipated. The breadth and depth of the recession has been wider and deeper than even the most seasoned economists had been able to predict during the early part of 2008.

The Authority's fiscal year 2009 budget document outlined for the board of directors the looming operating deficits for that and subsequent fiscal years. The board requested that staff prepare a position paper on the operating deficits and potential solutions for resolving them both in the short-term and the long-term. This was accomplished in early July 2008 and since that time the Authority's staff along with the facility management staff, finance committee and board of directors have been working to identify and/or implement potential solutions to this issue.

The following is a summary of what has been done or is currently being done:

- ☑ The first area targeted by the Authority and its facility management operator was the reduction of stadium and administrative operating costs. Through the combined efforts of both organizations a total of nearly \$1.1 million in cuts through the balance of fiscal year 2009 and an additional \$1.5 million in cuts for fiscal year 2010 have been identified with additional work being continued to identify and implement further reductions.
- ☑ In addition to these operating expenses reductions, we continue to look for ways to increase revenues. Currently, there exists the potential for several mega-events to be held at the stadium during fiscal year 2010 which would provide an additional significant boost to projected revenues. At the time of our response to the performance audit report, several of these mega-events have been announced including Gold Cup Soccer in July 2009 and Wrestlemania XXVI for March 2010. We believe that another two events could be announced within thirty days which will provide for significant revenue potential for the stadium.
- ☑ The Authority's board of directors in February 2009 approved a resolution allowing the Authority to temporarily suspend its existing Constant Maturity Swap in order to realize available present value savings based on its then current valuation. The Authority executed this 'lockout' of the swap and realized a net savings of \$1,062,000 on February 5, 2009.
- ☑ Another potential solution involves greater involvement by the Authority's tenants and partners at the stadium under a 'shared strategies' approach to events, event revenue and

operating costs. At the present time these discussions are in their preliminary stages but hold potential for both managing costs and increasing revenues.

- ☑ An additional strategy for the Authority is to identify possible legislative action(s) which could accrue additional benefit the Authority:
  - Return to its original, statutory position the funding for the Authority's operating budget. In 2002, the State legislature moved the operating budget funding to the fifth position behind the funding for youth and amateur sports. On a going-forward basis this would provide, given sufficient revenue sources, an additional \$1.8 million increasing by \$100,000 annually for stadium operating purposes.
  - Another possible legislative action would involve the collection of income taxes from visiting NFL teams and employees and remitting those income tax revenues to the Authority as is currently being done for the Cardinals' organization and employees. This would help replace the income that the Authority has lost as a result of the Auditor General's recommendation during our first performance audit which was enacted by the legislature in 2007 to eliminate the statutory minimum from the Authority's NFL income tax revenues.
  - The Authority continues to identify other possible legislative remedies

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## FINDING 2 - Authority should enhance its oversight of the facility manager

The Authority hired the stadium's facility manager based on variety of qualifications including their experience in managing other NFL facilities and facilities where varied and numerous events would be held annually. The Authority, through its agreement with the facility manager, defined a required list of deliverables which the facility manager provided to the Authority prior to the opening of the University of Phoenix Stadium. Among those deliverables were comprehensive manuals and/or plans for the following:

- ☑ Operation of the stadium including preventative maintenance, cleaning maintenance and capital replacement program, stadium and event security and more
- ☑ Accounting and financial control systems including cash handling, box office, procurement, event settlements, annual budgets, management and incentive fees and more
- ☑ Marketing and event booking programs for promoting and securing events of all types
- ☑ Energy management and conservation programs
- ☑ Employee handbook
- ☑ Training programs for safety, customer service and more

The Authority and facility management staffs meet on a regular basis, both formally and informally, to discuss the operation of the stadium. At scheduled monthly meetings, the detailed financial results for the stadium's operations are reviewed along with the facility manager's preventative and repair maintenance assessment, security issues and customer surveys. Due to the geographic proximity of the Authority's and facility manager's administrative offices within the stadium, frequent interactions and discussions on a variety of stadium-related issues occur between the two management staffs.

### Authority should establish a performance-based fee structure

The Authority's agreement with the facility manager defines the compensation to be paid to the facility manager. The compensation package is divided into two components – the fixed fee portion (i.e. the base fee) and the incentive portion. The compensation package is fairly standard within the facility management industry and, at the time the fees were negotiated, was considered to be a very favorable arrangement for the Authority based on other known agreements. In addition, there are definitive Internal Revenue Service guidelines which outline the terms and conditions within a management contract involved with the use of a bond-financed facility. The existing compensation for Global Spectrum has been vetted against the IRS guidelines and any future compensation arrangements will also be required to be defined within those guidelines.

The fixed, or base, portion of the management fee is designed to compensate the facility manager for the contracted services that are provided to the operation of the stadium. The incentive portion of the fee is based on performance and is divided equally into two categories – the objective incentive fee and the subjective incentive fee.

The objective incentive fee is tied to the facility manager's adjusted operating revenue performance. Operating revenues are adjusted for each event's direct costs to arrive at the adjusted operating revenue amount. The greater the number of events, the greater potential for higher adjusted operating revenues which is the basis for the calculation of the objective incentive fee. Therefore, the objective incentive fee is a performance-based fee.

The subjective incentive fee, as defined in the operating agreement, is determined by the input and feedback from the Authority (50%), the NFL franchise (40%) and the Fiesta Bowl (10%) as to the facility manager's performance and operation of the stadium as it relates to each of the three entities. The agreement further defines the Authority's criteria for rating the facility manager's performance in achieving or exceeding the annual plan and net operating profit/loss goals, targeted annual event and attendance figures, facility maintenance, customer satisfaction and other factors that merit consideration. Furthermore, as per the management agreement, the NFL franchise has developed specific performance criteria which they have utilized over the past two seasons to determine their portion of the facility manager's subjective incentive fee. The specific criteria include Game Management Operations, Safety and Security of Ticket Holders, Cooperation with/Enforcement of Team Rights, and Maintaining a Trained and Motivated Stadium Work Force. In addition, the Fiesta Bowl established minimum guidelines for operation against which the facility manager is evaluated. The guidelines include minimum standards for the following areas: Budgetary Results, Stadium Operations, Ticket Operations, Partnership/Communication and Facility Standards. Therefore, the subjective incentive fee is also a performance-based fee.

Prior to the current performance audit the Authority was planning on reviewing the compensation portion of the facility management agreement along with other sections of the agreement as part of our determination of whether or not to renew and/or extend the facility manager's term at the stadium. We do agree that if, within the confines of the Internal

Revenue Services guidelines, the incentive fees can be based on more performance criteria than currently exists we will work to implement those changes at the appropriate time.

Authority should improve its facility management contractor oversight

The Authority, per Arizona Revised Statute, was required to "...negotiate a contract with a management firm to operate, promote and market the multipurpose facility...". The Authority did this prior to the opening of the stadium and entered in a facility management agreement with the facility manager defining the terms and conditions under which they would perform stadium services as the agent for the Authority. Since the start of stadium services, the Authority and the facility manager have worked to develop and fine tune the various required sets of reports and documents per the agreement.

The primary oversight tool currently in use is the monthly financial report. This report provides the Authority with the following information:

- Prior month and fiscal year-to-date financial results for the facility manager using standard financial statements
- Profit and loss statements by event category which compare budget to actual and includes the number of event days and attendance
- Customer service survey analysis
- Preventative and repair maintenance work
- Detailed indirect expense financial comparisons
- Rolling profit and loss forecast through the end of the current fiscal year

The Authority, both during and outside of regularly scheduled review meetings, reviews and questions activities, both financially and operationally, with the facility manager. The proximity of both organizations' administrative offices makes it highly conducive to conducting impromptu, unscheduled review discussions.

The Auditor General has provided several examples of where they believe additional oversight should be injected. For example, in the area of preventative maintenance the Auditor General stated that "...the Authority does not regularly review the preventative maintenance schedule or ensure that it has been completed." The Authority has reviewed the preventative maintenance schedule and the work performed and will continue to do so while documenting these reviews.

The Authority will continue to develop and define ways in which to provide greater oversight of the facility manager's operations within the reasonable boundaries of the Authority's existing staff headcount and expertise.

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FINDING 3 - Minor improvements needed to better fulfill mission

We are appreciative of the recognition provided by the Auditor General in the report on the Authority's non-stadium activities of tourism funding, Cactus league promotion and youth and



amateur sports grant awards. Through the Authority's efforts in these three areas significant strides have been made to improve tourism and the economic benefit that it brings through tourism promotion and the financing of new or existing spring training baseball facilities. The Authority's agreement with the Maricopa County Stadium District has allowed the Cactus League to increase to the point where in 2010 when the Cincinnati Reds join the league, Arizona will possess the same number of training teams as does Florida. The Authority's youth and amateur sports grant awards are making a tremendous contribution to communities across Maricopa County and their impact on the lives of its citizens.

#### Policies for YAS grant awards

The Authority does recognize and is in agreement with the Auditor General's finding on minor changes required to our written policies and procedures for the youth and amateur sports program.

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#### Additional Points of Clarification – Performance Audit

##### Page 16 – Facility construction costs, Facility completion costs and Reimbursement to the Arizona Cardinals

- Authority's share of the stadium construction costs were based on the reality of a specific stadium design and its various components, rising construction material costs due to worldwide demand for steel and concrete and the need to fulfill its statutory obligation to design, finance and construct a multipurpose facility as mentioned 59 times in our enabling legislation.
- The \$53.4 million in additional costs as referred to by the report is a direct reflection of the Authority's issuance of an additional \$53.05 million in bonds in order to fulfill the City of Glendale's original obligations on the project as well as complete some of the Authority's unfunded stadium mandates for things such as stadium furniture, fixtures and equipment ("FFE") as well as change orders during the construction process in order to increase the efficiency of stadium operations (i.e. bowl wash down system, on-site storage for temporary seating, trash collection, etc.). The Authority paid approximately an additional \$2.4 million for stadium improvements following the opening of the stadium in August 2006 (i.e. AZSTA Grand Space and the party suites), \$3.2 million for stadium FFE in order for the facility manager to be able to operate the stadium and hold events as well as \$4.0 million for our contractual obligation to the Fiesta Bowl for an additional 9,000 seats for their games.
- The reimbursement to the Cardinals is related to those items that were originally the obligation of the City of Glendale. In order for the stadium to be completed on time the Authority and the Cardinals both stepped in financially to fulfill the obligations of Glendale. As part of this, the City pledged its sales and excise taxes generated at the stadium to the Authority for its use in repaying the \$53.05 million in additional bonds. The Authority took over the City's obligations to repay the Cardinals based on the pledge of the sales and excise taxes from the Glendale. If funds from these sources are sufficient to meet our debt

service, there will be reimbursements made to the Cardinals for these items starting around fiscal year 2012.

Page 18 – Authority is not reimbursed for football game day expenses

- ☑ The Authority receives the base state and local sales tax generated from ticket, food and beverage and merchandise sales related to the Arizona Cardinals home games and the annual Fiesta Bowl. Based on the Authority's annual budget projections, the amounts that are received from the sales tax recapture are sufficient to meet and/or exceed the actual amount expended by the Authority for the game day expenses. For the annual Fiesta Bowl game, the Authority also receives a per ticket surcharge as well as a facility use fee on each ticket sold.

Page 18 – Event revenues do not cover operating expenses

- ☑ The importance of the original funding plan and its reliance on the tourism revenues (i.e. hotel bed tax and car rental surcharge) and the NFL income tax and its guaranteed minimum has become painfully obvious during the past year. The removal of the NFL income tax guaranteed minimum since the start of fiscal year 2008 has meant a \$3.24 million revenue loss to the Authority. In addition, the legislature's action in 2002 to move the Authority's operating budget to the bottom of the funding waterfall has caused \$4.8 million in fewer funds for operations purposes as well as for building critical operating and repair and replacement reserves. The Authority has repeatedly stated that its operating reserves are absolutely critical to the Authority's ability to meet its obligations especially during the off-peak tourism season. The Authority receives its revenues based on actual results. We, however, must budget and allocate our funding for all of our statutory and non-statutory distributions on a one-twelfth basis over the course of the fiscal year. There is a significant imbalance during the first six months of each fiscal year with disbursements exceeding revenues on a historical basis.

Page 20 - Most events generate limited net revenue

- ☑ The audit report states that "...most events provide contributions of \$10,000 or less to overall facility net event revenue." We do not dispute the numbers behind this statement. We do contend, however, that, like other statements made in the report, it is important to note and take into account the overall, cumulative positive impact on the stadium's event revenues. When taken as a whole, these events provided a positive, net revenue amount to operations of more than \$188,000. While these events are modest on their own, they provide several direct benefits to the operation of the stadium:
  - they aide in filling in gaps in the stadium's event schedule,
  - they represent positive cash flow which helps to defray and cover the stadium's fixed overhead
  - they help to fulfill one of the facility manager's operational objectives of maximizing the number of events and operating revenues; and,

- they help to meet the current Auditor General recommendation (page 21) for increasing revenues.

#### Page 27 – Facility manager’s expenses

The performance audit report highlighted several travel related expenses that were reimbursed to the facility manager’s corporate office. The Authority agrees with the Auditor General that additional review and oversight of expenses is a good management practice. We do wish to add several points for additional clarification and explanation:

- ☑ The reimbursed costs were within the established operational guidelines for the facility manager
- ☑ The majority of these expenses were related to the facility manager’s corporate personnel and/or other non-Arizona-based facility personnel temporarily relocating to Arizona in order to assist the local facility management personnel, at no charge to the Authority, with producing events such as Super Bowl XLII and the Fiesta Bowl.
- ☑ Further internal analysis of the non-Arizona-based personnel’s total meal expenditures during their temporary relocation concluded that the average actual per day meal expense was lower than the State’s stated per diem meal expense reimbursement,