A REPORT
TO THE
ARIZONA LEGISLATURE

Performance Audit Division

Performance Audit

Arizona Sports and Tourism Authority

March • 2009
REPORT NO. 09-04

Debra K. Davenport
Auditor General

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OFFICE OF THE
AUDITOR GENERAL

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

March 16, 2009

Members of the Arizona Legislature

The Honorable Janice K. Brewer, Governor

Tom Sadler, President/Chief Executive Officer
Arizona Sports and Tourism Authority

Transmitted herewith is a report of the Auditor General, A Performance Audit of the Arizona Sports and Tourism Authority. This report is in response to Arizona Revised Statutes (A.R.S.) §5-812 and was conducted under the authority vested in the Auditor General by A.R.S. §41-1279.03. I am also transmitting with this report a copy of the Report Highlights for this audit to provide a quick summary for your convenience.

As outlined in its response, the Arizona Sports and Tourism Authority agrees with all of the findings and plans to implement all of the recommendations.

My staff and I will be pleased to discuss or clarify items in the report.

This report will be released to the public on March 17, 2009.

Sincerely,

Debbie Davenport
Auditor General

Attachment

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

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SUMMARY

The Office of the Auditor General has conducted a performance audit of the Arizona Sports and Tourism Authority (Authority) pursuant to Arizona Revised Statutes (A.R.S.) §5-812. This statute requires a performance audit no later than 2004 and at least every 5 years thereafter. This audit was conducted under the authority vested in the Auditor General by A.R.S. §41-1279.03.

The Legislature established the Authority in 2000 as a separate legal body of the State contingent upon voter approval of Proposition 302, which was obtained in the November 2000 election. As required by statute, the Authority built and operates a multipurpose facility known as University of Phoenix Stadium in Glendale, which is the home of the Arizona Cardinals football team and the Fiesta Bowl. The Authority also distributes monies to the Arizona Office of Tourism for tourism promotion. Finally, the Authority expends monies to help promote the development of new construction and renovation of existing Cactus League spring baseball facilities, and to promote the development of youth and amateur sports facilities and programs. All of these activities are performed in Maricopa County. The Authority's funding comes primarily from a 1 percent increase in hotel bed taxes and a 3.25 percent rental car surcharge in Maricopa County. Both funding sources will expire in 2031. The Authority also receives funding from state income taxes paid by the Cardinals organization and its employees and their spouses, rent for using the multipurpose facility, concession commissions, facility-use fees on tickets for authority events and Fiesta Bowl games, and state and City of Glendale sales taxes generated from events held at the multipurpose facility.

Authority should continue to address its financial situation (see pages 11 through 22)

The Authority has reported operating deficits for fiscal years 2002, 2006, and 2008 of \$78,103, \$3,381,792, and \$457,536, respectively, and projects that costs will exceed revenues from fiscal years 2009 through 2014. Once the bond debt service and other statutorily required distributions are made, projected revenues will be insufficient to pay for all of the facility's projected operating expenses. Although the Authority can use its operating reserve balance to cover these shortfalls for fiscal year 2009, this \$8.7 million reserve balance as of June 30, 2008, may be exhausted in fiscal year 2010. In total, authority projections show that operating expenses will exceed available monies by almost \$29 million through fiscal year 2014.

Further, these projections do not account for the establishment and maintenance of three statutorily required reserves including a capital repair and replacement reserve of $25 million adjusted for inflation each year after 2001, an operating reserve, and an annual increase of $100,000 to the youth and amateur sports reserve. As of June 30, 2008, although the Authority had fully funded the youth and amateur sports reserve and had an $8.7 reserve balance in its operating account, the capital repair and replacement reserve, which is critical for addressing future major capital needs as the facility ages, had not received any funding. Additionally, the Authority's projected revenue is insufficient to either fund or maintain these reserve amounts in the future.

Many factors contribute to the Authority's financial situation. Specifically:

- Lower NFL income tax collections—These collections, which consist of the Arizona state income taxes paid by the Arizona Cardinals' corporation and employees, including players and their spouses, and are distributed to the Authority, have not grown as projected. Growth in these revenues was originally projected at 8 percent annually, but has actually increased by an average of 2.2 percent annually. For example, based on the 8 percent growth projection, the Authority should have received almost $5.6 million in fiscal year 2008, but instead received slightly more than $4.1 million.

- Authority decisions—Various authority decisions have reduced available monies and resulted in additional debt obligations. These include increased multipurpose facility construction costs. The Authority's $299.4 million share of these costs was $53.4 million more than originally projected. According to the Authority, the increased costs of construction materials contributed to the higher facility construction costs. Additionally, according to the Authority, $32.3 million of the increased costs were for site improvements that were originally to be funded by the City of Glendale (City). Instead, the City remits to the Authority city sales tax revenues from sales at the facility to help repay bonds the Authority issued to pay for the site improvements. According to the Authority, to fulfill a contract obligation and enhance the operational aspects of the facility, it also paid an additional $9.61 million in facility interior improvements to add temporary seating, furniture, fixtures, equipment, and meeting space. Between fiscal years 2012 and 2020, the Authority expects it will pay a total of approximately $15 million to the Cardinals pursuant to an agreement to reimburse the Cardinals for land acquisition, site improvements, and stadium costs that were originally the City's obligation, but that the Cardinals agreed to pay to help ensure the facility was completed on time.

- Event expenses—The Authority pays unreimbursed Cardinals' game day expenses, which were more than $2.3 million annually in fiscal years 2007 and 2008, while the Cardinals receive all game day revenues. The Authority receives a portion of all sales tax revenues generated at the Cardinals' games. The

Authority also agreed to pay $300,000 of annual Fiesta Bowl game day expenses, with this amount increasing annually at 2 percent through 2035, in exchange for the Fiesta Bowl's paying $5.2 million toward the multipurpose facility's interior improvement costs. Further, although operating revenues were never expected to cover all operating expenses and it was planned for the Authority to use nonoperating revenues to help pay for operating expenses, unrecovered operating costs were approximately $8.6 million in fiscal year 2007 and $9.1 million in fiscal year 2008.

- Declining Tourism Revenues—Economic conditions could significantly impact the Authority's revenues. Although combined hotel bed tax and car rental surcharge revenues had grown an average of 7.9 percent annually through fiscal year 2007, they decreased almost 1 percent in fiscal year 2008 from almost $24.3 million in fiscal year 2007 to less than $24.1 million in fiscal year 2008. Additionally, revenues for the first 6 months of fiscal year 2009 were 3.3 percent lower than for the same period of fiscal year 2008.

The Authority has begun to take steps to address its financial situation and should continue these efforts. With the help of the Arizona Cardinals, additional NFL state income taxes paid in 2005 and 2006 totaling nearly $1.2 million have been identified and will be distributed to the Authority in fiscal year 2010. The Authority is also exploring revising its business plan for multipurpose facility operations by working with its facility manager to reduce operating costs by at least $1 million in fiscal year 2009 and by another undetermined amount in fiscal year 2010. Finally, on February 3, 2009, the Authority suspended one of its interest rate swap agreements for a 2-year period and received payment of more than $1 million. Additional options the Authority could consider include seeking an increase in dedicated tax sources; increasing the Authority's facility-use fee; seeking to reorder the statutory funding priorities or reduce the amount of required payments for tourism, Cactus League, and youth and amateur sports; and renegotiating its agreements with the Arizona Cardinals to receive a contribution for game day expenses and with the Fiesta Bowl to receive facility rent.

Authority should enhance its oversight of the facility manager (see pages 23 through 29)

The Authority contracted with a facility management company (facility manager) to manage and operate the multipurpose facility. The facility manager is responsible for all aspects of facility management and operations, including marketing, maintenance, security, and finances. The facility manager pays all of its and the facility's expenses from an authority bank account that the Authority authorized the facility manager to establish to pay for the facility's marketing, operation, and management expenses. The Authority also pays the facility manager an annual fixed management fee and incentive fee. However, the Authority should revise its management agreement to establish a more performance-based incentive fee structure. Currently, half of the incentive fee is based on 5 percent of all adjusted operating revenues not obtained from Arizona Cardinals and Fiesta Bowl events, while the other half of the incentive fee is based on subjective criteria established by the Authority, Cardinals, and Fiesta Bowl. An authority official indicated that the Authority is planning to revisit the incentive fee structure. In doing so, the Authority should also ensure that the fee structure conforms with U.S. Internal Revenue Service regulations regarding management fees for facilities financed by tax-exempt bonds, such as the multipurpose facility.

Additionally, the Authority has performed limited contractor oversight and should increase facility manager monitoring and oversight. The Authority's monitoring efforts center on reviewing high-level financial reports, such as financial statements and budgets, and attending monthly meetings with facility manager staff. However, this level of monitoring does not ensure the adequate operation of the multipurpose facility and appropriate expenditure of the Authority's monies. Therefore, 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.

Minor improvements needed to better fulfill mission (see pages 31 through 36)

The Authority has taken steps to fulfill its purposes, but it can make some minor improvements. The Authority has met statutory requirements to fund tourism, Cactus League, and youth and amateur sports promotion. For example, the Authority distributed almost $5.4 million to the Arizona Office of Tourism (Office) in fiscal year 2008, and the Office in turn redistributed these monies to local tourism promotion agencies in Maricopa County. These monies represented nearly 25 percent of all tourism promotion funding for those local agencies for fiscal years 2006 to 2008.

Additionally, the Authority has created appropriate policies and procedures for expending its Cactus League monies and committed nearly $403.1 million through fiscal year 2031 to assist in developing the Cactus League in Maricopa County. This commitment represents all $205 million required to be distributed under the Authority's statutes through fiscal year 2031 and an additional projected $198.1 million from an authority agreement with the Maricopa County Stadium District.

Finally, minor improvements to the Authority's youth and amateur sports grant program could further advance efforts to promote youth and amateur sports activities. The Authority reports that it has authorized $11.3 million in funding for more than 110 youth and amateur sports facilities and programs in Maricopa County through fiscal year 2008. The Authority follows its grant application, grant-award criteria, and cost-reimbursement policies and procedures, but some policies and procedures should be updated.

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INTRODUCTION & BACKGROUND

The Office of the Auditor General has conducted a performance audit of the Arizona Sports and Tourism Authority (Authority) pursuant to Arizona Revised Statutes (A.R.S.) §5-812. This statute requires a performance audit no later than 2004 and at least every 5 years thereafter. This audit was conducted under the authority vested in the Auditor General by A.R.S. §41-1279.03.

Authority responsibilities and history

According to A.R.S. §§5-807 through 5-809 and 5-835(B)(2), the Authority has the following responsibilities, which are limited to the Maricopa County area:

- Constructing and operating a multipurpose event facility. To fulfill this mandate, the Authority built a multipurpose facility in Glendale named the University of Phoenix Stadium and began operating it in August 2006. It serves as the home for the Arizona Cardinals football team (Cardinals) and Fiesta Bowl games, and hosts other sporting events, concerts, motorsports events, trade and consumer shows, meetings, and banquets;

- Distributing monies to the Arizona Office of Tourism for tourism promotion;

- Attracting and retaining major league baseball spring training operations to locations in Maricopa County; and

- Reviewing, approving, and funding grants for youth and amateur sports facilities and programs within Maricopa County.

The creation of the Authority resulted from the Governor's Stadium Plan "B" Advisory Task Force (Task Force) established by Governor Jane Hull in 1999. The Governor established this task force following the electoral defeat of an effort by the City of Mesa to finance a new stadium for the Arizona Cardinals football team. The Task Force was charged with studying funding options to construct a new football stadium that would minimize the impact to the average Arizona resident. In response to this charge, the Task Force proposed new tourism taxes and other revenue sources, including a contribution from the Cardinals, to finance a new multipurpose facility. Additionally, the Task Force believed that other threats to the State's tourism tax base existed, such as other competing tourism destinations and the possible loss of Cactus League spring training teams to other states. It concluded that any effort to finance and build a stadium should also include resources to promote tourism in Arizona.

Following the work of the Task Force, the Legislature established the Authority in 2000 as a separate legal body of the State, conditioned on voter approval. Maricopa County voters subsequently approved the Authority in the November 2000 election through the passage of Proposition 302. A.R.S. §5-802 establishes the Authority as a separate legal body with all of the rights, powers, and immunities of a municipal corporation. A.R.S. §§5-836(D) and 5-875(C)(4-5) provide that the State of Arizona is not financially liable for any of the Authority's expenses or obligations.

Funding sources

The Authority receives funding from various sources, which is used to satisfy several bond and statutory funding obligations. Specifically, the Authority receives:

- **Hotel bed tax increase**—Revenue from a 1 percent increase in the hotel bed tax in Maricopa County.[1] By statute, this revenue source expires February 28, 2031.

- **Car rental surcharge**—Consists of a 3.25 percent surcharge on car rentals in Maricopa County, which also expires on February 28, 2031. This surcharge replaced a previously existing $2.50 flat surcharge for each car rental contract that was distributed to the Maricopa County Stadium District (District) to renovate existing and construct new Cactus League baseball facilities. Although the first $2.50 from each rental car contract continues to be distributed to the District, in accordance with a 2003 agreement with the District, the Authority now receives the District's rental car surcharge revenues that are not needed to retire the District's Cactus League bonds. The Authority will receive the full surcharge when these bonds are retired. According to the agreement, the Authority can use only the District's portion of the surcharge for Cactus League projects.

- **Sales tax recapture**—The State Treasurer distributes the base portion of state sales taxes (5 percent) received from Cardinals games, the Fiesta Bowl, and all other events held at the multipurpose facility to the Authority. In addition, according to a 2005 agreement with the Authority, the City of Glendale remits city sales taxes resulting from transactions at the multipurpose facility to the Authority in exchange for the Authority issuing $32.3 million in bonds for site improvement costs that were the City of Glendale's responsibility.

1 Hotel bed tax rates vary among cities in Maricopa County. For example, as of October 14, 2008, hotel bed taxes were 12.27 percent in Phoenix and 11.92 percent in Scottsdale, according to information on each City's Web site.

- **NFL Income Tax**—All Arizona state income taxes paid by the Cardinals' corporate organization, its employees (including players), and their spouses.

- **Cardinals rent payments**—According to its agreement with the Authority, the Cardinals pay annual rent starting at $250,000 in fiscal year 2007 and increasing by 2 percent annually through the term of its 30-year lease, which expires in fiscal year 2036. The Cardinals have the option to extend this lease a total of six times for 5 years each time.

- **Fiesta Bowl payments**—According to its agreement with the Authority, the Fiesta Bowl pays $2.50 for each Fiesta Bowl ticket sold, and the amount increases by $0.20 per ticket annually through the term of its 30-year lease, which expires in 2036. The Fiesta Bowl has the option to extend this lease a total of six times for 5 years each time.

- **Other event revenues**—Includes rental payments for using the facility, concessions commissions, and facility-use fees for events held at the facility. The facility-use fee consists of a $4.25 ticket surcharge for nongeneral admission seating at events, including Fiesta Bowl games, with estimated attendance of 18,000 or more and increases by $0.25 annually. The facility use fee is $1 per ticket for nongeneral admission seating at events with estimated attendance of less than 18,000 or for all general admission events, and increases by $1 every 7 years from August 2006.

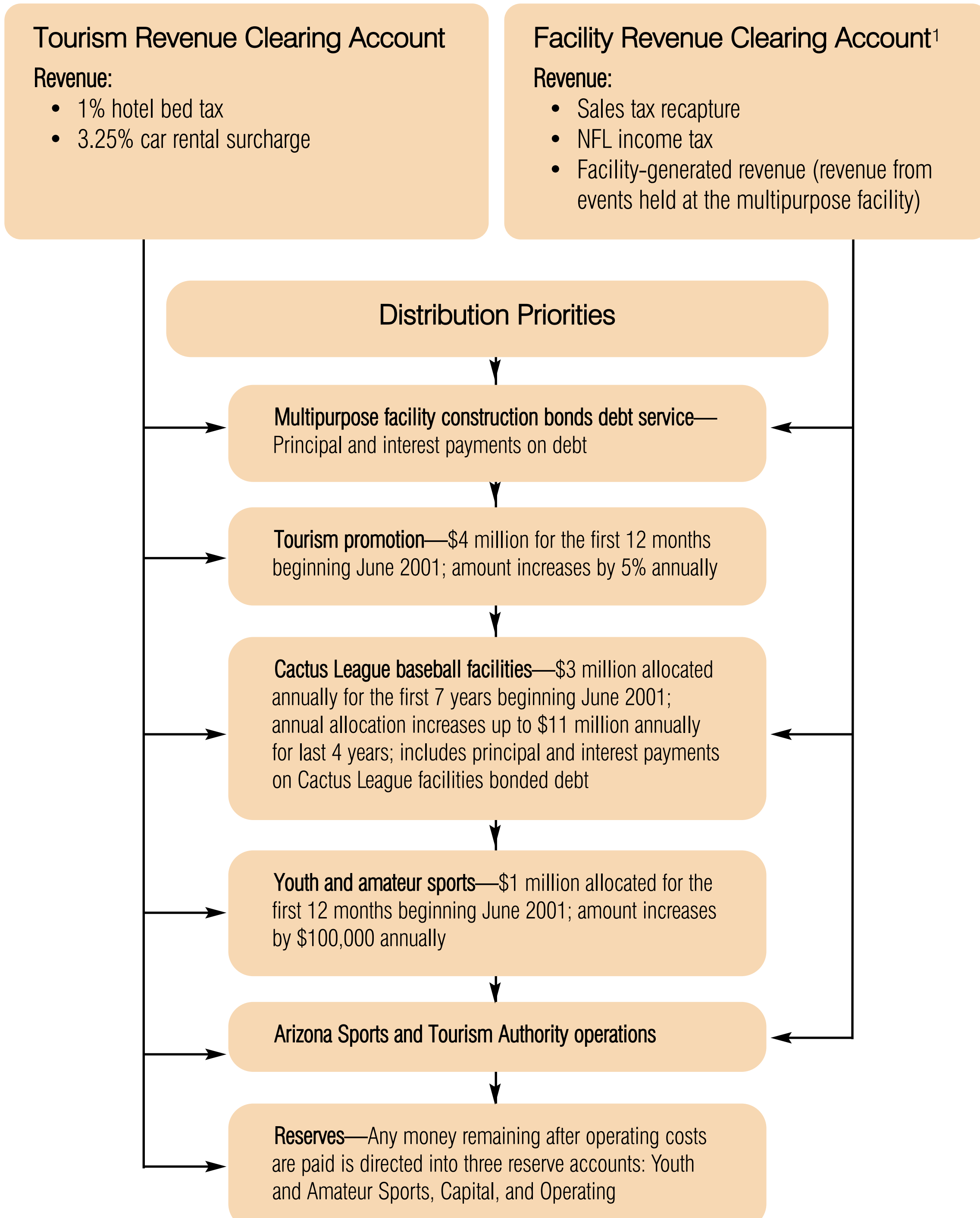
Authority's spending priorities

Statutes establish amounts and a priority order for spending the Authority's revenues. Specifically, A.R.S. §5-835 requires the Authority to maintain a tourism revenue clearing account for the hotel bed tax and car rental surcharge revenues. In addition, A.R.S. §5-834 requires the Authority to maintain a facility revenue clearing account for all other revenues. These statutes further direct how the Authority must distribute monies in these accounts and specify that lower spending priorities cannot be funded until higher spending priorities are fully funded. Figure 1 (see page 4) illustrates the spending priorities for both the tourism revenue clearing and facility revenue clearing accounts.

Tourism revenue clearing account—The Authority must use monies from this account for the following purposes in priority order:

1. **Bond debt service**—The Authority must first satisfy its debt service obligations for bonds it issued to pay for its share of the multipurpose facility's design and construction costs. The Authority issued $277.58 million in bonds to pay its share of construction costs in addition to other cash payments. The majority

Figure 1: Revenue Distributions in Statutory Priority Order



1 Revenue in the facility revenue clearing account is used first to make principal and interest payments on the multipurpose facility bonded debt, then for Cactus League baseball facilities bonded debt if the tourism revenue clearing account lacks sufficient monies to make these payments. Any facility revenue clearing account monies not needed for debt payments are available for authority operations.

Source: Auditor General staff analysis of A.R.S. §§5-834, 5-835, and 5-836.

of these bonds will be retired by 2031, but some bonds will not be fully retired until 2036. The Authority projects that, with interest, approximately $577.5 million will be paid to retire the bonds.

2. **Tourism promotion**—Statute next requires the Authority to distribute monies to the Arizona Office of Tourism to promote tourism in Maricopa County. A.R.S. §5-835 requires the Authority to distribute $4 million annually, increasing at 5 percent each year. As of June 30, 2008, the Authority had distributed more than $33 million and will distribute approximately $265.8 million through fiscal year 2031 when the hotel tax and car rental surcharge expire.

3. **Cactus League promotion**—Statute then requires the Authority to contribute to the construction and renovation costs of new and existing Cactus League baseball spring training facilities to lure new teams and keep existing teams in Maricopa County. Statute requires the Authority to spend $205 million through 2031 for Cactus League promotion. This amount, combined with $198.1 million that the Authority estimates it will receive from its Maricopa County Stadium District agreement, will result in an estimated $403.1 million spent for Cactus League promotion through fiscal year 2031.

4. **Youth and amateur sports**—After Cactus League baseball, statute requires the Authority to fund youth and amateur sports facilities and programs. A.R.S. §5-835 required initial annual funding of $1 million, increasing by $100,000 each year, and will require the Authority to spend $73.5 million promoting youth and amateur sports through fiscal year 2031.

5. **Operations and administration**—After funding the previous priorities, statute requires funding the Authority's approved annual operating budget. The approved operating budget for fiscal year 2009 is approximately $13.7 million. In 2002, the Legislature moved the Authority's operating budget from the fourth to the fifth funding priority after youth and amateur sports.

   As a lower funding priority, authority operations are at risk for not receiving full funding. Authority projections prepared during the audit indicate that annual revenue and available operating reserves are insufficient to fully fund projected operating costs by almost $29 million through fiscal year 2014. The Authority projects that it will deplete its operating reserves in fiscal year 2010 and will be unable to fully fund its operations thereafter (See Finding 1, pages 11 through 22, for information on the Authority's financial situation).

6. **Youth and amateur sports reserve**—After operations, the Authority must fund a reserve account for youth and amateur sports equal to the previous year's required distribution amount. The required reserve amount of $1,508,333 for fiscal year 2008 was fully funded as of June 30, 2008.

7. **Operating account**—If monies remain after meeting the previous priorities, then the Authority must deposit any unallocated monies to its operating account.

Facility revenue clearing account—This account has two general funding obligations. First, monies from this account must be used to satisfy debt service obligations for both its multipurpose facility and Cactus League bonds if its tourism revenue clearing account lacks sufficient monies to meet these obligations. Second, the Authority must distribute any monies not needed for debt payments to its operating account.

Statute also requires the Authority to establish two reserves in its operating account, one for operations and one for repairs and other long-term multipurpose facility costs. Although statute does not establish a reserve amount for operations, the Authority's goal is to maintain an operations reserve equal to the prior year's operating budget. Statute directs the Authority to establish a reserve of $25 million adjusted for inflation each year after 2001 for facility repair and replacement costs. As of June 30, 2008, monies held in reserve for operations totaled approximately $8.7 million, and no monies had been placed in the reserve account for capital repairs and replacement.

Multipurpose facility and operations

The multipurpose facility has a retractable roof and playing field.

The multipurpose facility (University of Phoenix Stadium) is an enclosed air-conditioned structure with approximately 63,400 permanent seats expandable to 72,200 seats with a retractable roof and natural grass playing surface. Authority officials stated that having the retractable field increases the facility's multipurpose functionality and helps the Authority attract nonsporting events such as consumer shows, conventions, concerts, graduations, banquets, and religious gatherings. Facility construction began in July 2003, and the facility opened in August 2006. The Arizona Cardinals and the City of Glendale (City) also shared in the construction, land acquisition, and infrastructure development costs for the multipurpose facility. The Cardinals contributed $140.3 million and the City contributed $6.7 million of the $446.4 million cost. While the Authority owns and operates the facility and the 25.3 acres of land the structure sits on, the Cardinals are the primary tenant and own the surrounding 140 acres, including the parking lot and landscaped areas.

The Authority has entered into the following contracts and agreements to help operate the multipurpose facility:

- **Facility operations**—After completing a competitive procurement process, the Authority contracted with a facility management company (facility manager) in May 2004 to provide comprehensive facility management and operating services for a period of 36 months after the facility opened with an option for two 12-month extensions. The facility manager is responsible for day-to-day facility operations, including marketing, maintenance, security, and managing the concessionaire. The contract requires the facility manager to manage and operate the facility to meet several criteria, including maintaining and operating the facility as a first-class multipurpose sports, public assembly, exhibit, entertainment, concert, convention, and trade show facility; maximizing operating revenues while minimizing operating expenses; and maximizing the number of events and event attendance.

The Authority compensates the facility manager on a cost plus management fee basis, and the facility manager pays all of its expenses directly from an authority bank account that the Authority authorized the facility manager to establish to pay for the facility's marketing, operation, and management expenses. The facility manager prepares an annual budget approved by the Authority's Finance Committee and Board of Directors.

The facility manager pays all of its expenses from an authority bank account.

In addition to paying all of the facility manager's expenses, the agreement requires the Authority to pay a fixed fee of $200,000 for the first 12-month period beginning in August 2006, increasing by $30,000 for each successive 12-month period. The facility manager is also entitled to an annual incentive fee that cannot exceed the fixed fee. Fifty percent of the incentive fee, or $100,000 for the first year, is calculated on an objective basis as 5 percent of the adjusted operating revenues that accrue to the Authority for all nonfootball events. The facility manager received all of the objective part of the incentive fee for fiscal years 2007 and 2008. The remaining 50 percent of the incentive fee is calculated subjectively depending on the facility manager's performance as jointly assessed by the Authority, the Arizona Cardinals, and the Fiesta Bowl. The facility manager received most of the subjective incentive fee for fiscal year 2007. As of December 2008, the subjective incentive fee had yet to be determined for fiscal year 2008.

As of June 30, 2008, the facility manager employed 55 full-time employees and 210 part-time employees, and subcontracted with a security firm to provide security services.

- Concessions agreement—Using competitive procurement practices, the Authority and the Cardinals contracted with a concessionaire to exclusively provide food and beverage services at the multipurpose facility for 2 years beginning with the facility's opening in August 2006. The Authority may extend the agreement for two 1-year terms and exercised its first option to renew the agreement in August 2007. The Cardinals must also approve any extensions beyond 2 years. According to its agreement, the facility manager supervises the concessionaire. The Authority receives between 47 and 50 percent of the revenues from gross general concession sales for the Authority's events, and the Cardinals and Fiesta Bowl receive this commission for their events. The concessionaire retains the remainder of gross sales. The Authority owns all concession facilities and equipment, and issued $2.25 million in noninterest-bearing promissory notes to the concessionaire for purchasing smallwares, including such things as pizza cutters, platters, bowls, and equipment.

- **Box office operations**—Under the Authority's agreement with the Cardinals, the Cardinals staff operate the facility box office for all events held at the facility, but promoters may provide their own staffing on event days, and the Fiesta Bowl may establish its own box offices.

Follow up on 2004 performance audit

The Office of the Auditor General previously conducted a performance audit of the Authority in 2004 (See Report No. 04-01) and reported four findings. These findings included the following information:

The multipurpose facility's final construction cost totaled $446.4 million.

- **Multipurpose facility's estimated construction cost**—The 2004 performance audit found that the facility's cost increased to $370.6 million from the original $331 million estimated cost. The Authority had various mechanisms and a budget in place for overseeing construction that, if used properly, could help limit the Authority's liability for future cost overruns. However, the facility's final construction cost totaled $446.4 million, and the Authority's contribution increased from an estimated $266.6 million in 2004 to $299.4 million (See Finding 1, pages 11 through 22, for more information).

- **State General Fund support for the Authority**—The 2004 performance audit reported that statute provided a State General Fund subsidy to the Authority when its NFL income tax revenues did not meet a minimum amount that increased by 8 percent annually. Because actual NFL income tax collections did not grow at 8 percent annually, the Authority would receive over $2.6 million from fiscal year 2003 through 2005 in State General Fund subsidies. Citing concerns with the basis for the projected 8 percent growth and potential economic downturns or player strikes, the report recommended several options for legislative consideration to potentially limit or otherwise control State General Fund disbursements to the Authority. In 2007, the Legislature revised statute to limit disbursements to actual NFL income tax collections.

- **Guidelines needed to evaluate funding requests**—The 2004 performance audit also recommended that the Authority develop guidelines and implement policies and procedures for funding youth and amateur sports grants and Cactus League projects. In response, the Authority developed and implemented recommended guidelines, policies, and procedures.

- **Changes to administrative practices needed**—Finally, the 2004 performance audit found that the Authority could improve its administrative practices in the areas of procurement, travel policies and reimbursements, gift policies, internal controls, and the use of a luxury suite at the facility. The Authority took appropriate action to address these items, including reducing its attorney fees.

  In March 2006, the Authority engaged a consultant to review its spending for travel, lodging, and meal expenses and whether these expenses conformed with state law and authority policy. The consultant concluded that the Authority's travel, lodging, and meal expenses were kept within reasonable limits and did not violate any law or authority policy for the 5 years that were reviewed.

Organization and staffing

The Authority is governed by a nine-member board of directors. The Governor appoints five board members who represent the tourism industry, hotel and motel industry, youth sports organizations, and Major League Baseball spring training organizations. The Senate President and House Speaker each appoint two members who cannot both be from the same political party. All members serve 5-year terms and may be reappointed for one full subsequent term.

As of October 10, 2008, the Authority had four employees, including a president/chief executive officer, a treasurer/chief financial officer, a communications coordinator, and an executive assistant/office manager. The Authority mainly uses contracted services for managing, promoting, operating, and maintaining the multipurpose facility and uses outside legal representation.

Scope and objectives

This audit focused on the Authority's financial situation and whether future revenues will be sufficient to satisfy its statutory obligations and pay for multipurpose facility operations, its oversight and monitoring of the facility manager, and whether the Authority is meeting its statutorily defined purposes.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The Auditor General and staff express appreciation to the Authority's Board of Directors, the President/Chief Executive Officer, and staff for their cooperation and assistance throughout the audit.

FINDING 1

Authority should continue to address its financial situation

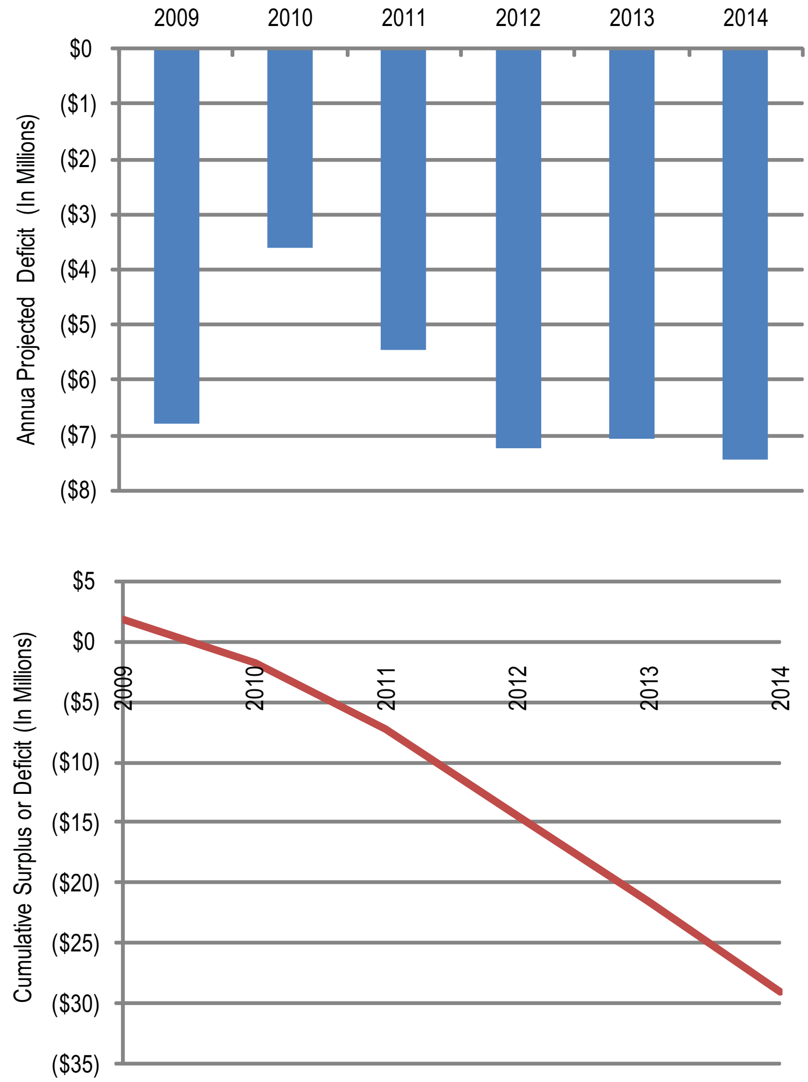
The Arizona Sports and Tourism Authority (Authority) should continue to address its operating deficit. In fiscal year 2008, the Authority reported a $457,536 operating deficit, and the situation is expected to worsen, with operating reserves projected to be depleted in fiscal year 2010. Authority-prepared financial projections show that the Authority will receive sufficient revenue to pay bond debt service and other statutorily required distributions, but projected revenue will not fully fund the Authority's operating budget and required reserve accounts. Lower-than-projected NFL state income tax revenues, increased expenses, declining event income, and decreasing revenues from the hotel bed tax and car rental surcharge contribute to the Authority's weakened financial position. The Authority should continue to take steps to improve its financial condition and identify options for increasing monies available for operating expenses and/or decrease its expenses.

Authority operating with a financial deficit

The Authority reported an operating deficit in fiscal years 2002, 2006, and 2008, and projects that expenses and other uses will exceed revenue sources for fiscal years 2009 through 2014. Specifically, the Authority reported operating deficits for fiscal years 2002, 2006, and 2008 of $78,103, $3,381,792, and $457,536, respectively. Any deficits reduce available monies in the Authority's operating reserve, which the Authority reported as approximately $8.7 million as of June 30, 2008. As illustrated in Figure 2 (see page 12), the Authority projects an operating deficit of approximately $6.8 million in fiscal year 2009 and additional deficits in each fiscal year through fiscal year 2014, with the highest annual deficit of almost $7.5 million estimated for fiscal year 2014.[1] The Authority also projects operating deficits to continue past fiscal year 2014.

1 For the most part, authority-prepared revenue sources and use projections appear reasonable. Specifically, auditors compared prior projections to historical revenues and historical revenues to current projections and found that, with the exception of NFL income tax projections (see pages 14-15), projected growth in revenues was consistent with historical growth or contractual requirements. Although the Authority has projected NFL income tax collections to annually grow at 5 percent, annual growth for these collections has actually only averaged 2.2 percent. This includes additional amounts in NFL income tax collections recently identified from 2005 and 2006 tax years that will be paid in fiscal year 2010. Projected uses of those sources also appear reasonable. For example, projected tourism, Cactus League, and youth and amateur sports promotion distributions are stated as required by statutes. The Authority's projected bond payments closely match amounts required in bond statements. Projected operating expenses appear reasonable compared to historical amounts, but exclude any provision for unusual or capital items, and the projections do not include accumulation of required reserve monies (see pages 13-14). According to an authority official, the Authority did not include capital repair and replacement costs in its projections because projected revenues were not sufficient to include them.

Figure 2: Projected Annual and Total Cumulative Operating Surplus or Deficit[1]
Fiscal Years 2009 through 2014
(Unaudited)



1 The top graph presents the projected difference between total authority revenue sources less total distributions and operating costs of the Authority in fiscal year. The bottom graph presents the projected cumulative surplus or deficit at the end of each fiscal year.

Source: Auditor General staff analysis of the Authority's revenue and expense projections prepared by authority staff as of October 19, 2008 and November 25, 2008.

Operating reserve monies are projected to be depleted during fiscal year 2010.

Although the Authority reported some operating reserve monies as of June 30, 2008, these monies will be depleted in fiscal year 2010 based on the Authority's projections. Specifically, as of June 30, 2008, the Authority reported approximately $8.7 million in its operating reserve account. This amount is sufficient to absorb the projected fiscal year 2009 deficit, but will not cover the projected fiscal year 2010 deficit and annual deficits thereafter. The Authority's November 25, 2008, projections estimated that operating reserves will be depleted and that the Authority will begin operating at a deficit during October 2009. As shown in Figure 2 (see page 12), the Authority projects that its operating expenses and other uses will exceed projected monies available to fund operating costs by almost $29 million through fiscal year 2014.

Sufficient revenues for obligations except operating expenses and funding all reserves

The Authority projects that it will receive sufficient revenues to meet its bond service obligations and statutorily required annual distributions for tourism promotion, Cactus League development, and youth and amateur sports. However, projected revenues will be inadequate to fund all of the Authority's costs for operating the multipurpose facility and to establish and maintain statutorily required reserve accounts. Table 1 illustrates how the Authority's projected revenues available for operations will fall short of funding projected operating expenses by $3.6 million to nearly $7.5 million annually from fiscal years 2009 through 2014.

In addition, the Authority's projected revenue is insufficient to fund the three statutorily required reserve accounts. Specifically:

Table 1: Summary of Projected Unfunded Facility-Operating Costs
Fiscal Years 2009 through 2014
(Unaudited)

Fiscal Year	Projected Revenues Available for Operations after Higher Funding Priorities	Projected Facility Operating Costs	Unfunded Facility Operating Costs
2009	$6,863,296	$13,652,037	$6,788,741
2010	11,747,616	14,198,119	3,623,503
2011	9,293,522	14,766,043	5,472,521
2012	8,118,375	15,356,685	7,238,310
2013	8,895,538	15,970,953	7,075,415
2014	9,141,709	16,609,791	7,468,082

Source: Auditor General staff analysis of the Authority's revenue and expense projections prepared by authority staff as of October 19, 2008, and November 25, 2008.

- **Youth and amateur sports reserve**—According to A.R.S. §§5-838(B) and 5-835(B)(6), the Authority is required to establish and maintain a youth and amateur sports reserve equal to the prior year's distribution to youth and amateur sports projects. Since distributions to these projects increase by $100,000 annually, the required reserve amount must also increase by $100,000 annually. Although this reserve amount was fully funded at $1,508,333 as of June 30, 2008, based on the Authority's projections, it will not be able to increase this amount by $100,000 annually as required.

- **Operating reserve**—According to A.R.S. §5-836(C)(1), the Authority is required to establish and maintain sufficient reserves to meet future operating costs and pay all costs associated with events held at the multipurpose facility. Although statute does not specify a required reserve amount, according to the Authority's policy, its goal is to establish an operating reserve equal to the prior year's operating budget, which was nearly $13 million for fiscal year 2008. However, although the Authority reported an operating reserve totaling approximately $8.7 million as of June 30, 2008, based on projections, the Authority will not be able to set aside additional monies for its operating reserve and will deplete this balance sometime in fiscal year 2010.

- **Capital repair and replacement reserve**—Finally, according to A.R.S. §5-836(C)(2), the Authority is required to establish a reserve of at least $25 million, adjusted for inflation each year after 2001, to meet facility repair, replacement, and removal costs. This reserve account is critical to addressing major capital repairs and renovations that arise as the facility ages. However, the Authority reported that it has never funded this reserve and projects that it will not be able to do so because, according to the Authority's policy, it should first fully fund the operating reserve before funding the capital repair and replacement reserve.

Projected revenues are insufficient to fund reserve accounts, including capital repairs and renovations.

Several factors contribute to the Authority's financial situation

Various factors contribute to the Authority's deficit financial situation. First, NFL state income tax collections from the Arizona Cardinals' corporation and employees, including players and their spouses, were reported lower than anticipated. Additionally, several of the Authority's decisions have negatively affected multipurpose facility costs and revenues. The Authority also absorbs significant game day costs for Arizona Cardinals and Fiesta Bowl football games without reimbursement. Further, revenues from nonfootball events do not cover the facility's operating costs and have decreased because of fewer events. Finally, economic conditions have begun to negatively effect the revenues that the Authority receives from the hotel bed tax and car rental surcharge.

NFL tax revenues not coming in as projected—By statute, the Authority receives all Arizona state income taxes paid by the Cardinals' corporate organization, its employees, and their spouses. Originally, the statute provided for the Authority to receive a minimum of $3.5 million in fiscal year 2002 in NFL income tax revenues, with this amount increasing by 8 percent annually. Further, the State Treasurer was required to pay any shortfall in actual NFL income tax collections from the State General Fund. The Authority received more than $26.6 million in NFL income tax revenues, which included State General Fund subsidies, during fiscal

years 2002 through 2007. However, as illustrated in Table 2, because actual NFL income tax collections did not meet projections, the State General Fund paid out nearly $4.3 million during this period to meet the guaranteed minimum amount.

Table 2: Schedule of NFL Income Tax Collections, State-Guaranteed Minimum, and State General Fund Subsidy
Fiscal Years 2002 through 2008
(Unaudited)

Fiscal Year	NFL Income Tax Collections	State Guaranteed Minimum	State General Fund Subsidy
2002	$ 4,420,872	$ 3,504,000	$ 0
2003	3,578,944	3,784,320	205,376
2004	2,842,359	4,087,066	1,244,709
2005	3,224,321	4,414,032	1,189,711
2006	3,710,742	4,767,154	1,056,414
2007	4,586,341	5,148,527	562,185
Subtotal	$22,363,579	$25,705,099	$4,258,395
2008	$ 4,121,337	$ 5,560,409[1]	$1,439,072[2]

1 The minimum guaranteed amount to be subsidized from State General Fund revenues was repealed in 2007 and did not apply to fiscal years 2008 and later.

2 The subsidy amount shown is what would have been paid if the guaranteed minimum had not been repealed.

Source: Auditor General staff analysis of NFL income tax data provided by the Authority.

The Legislature repealed the State General Fund subsidy in 2007, limiting distributions to the Authority to actual NFL income tax collections. Table 2 shows that if this had not been done, more than $1.4 million in State General Fund monies would have been distributed to the Authority in fiscal year 2008. Additionally, auditors' analysis of the Authority's projections and actual NFL income tax collections found that the required General Fund subsidy, if not repealed, could have totaled as much as $193 million from fiscal years 2008 through 2031. This is because the Authority projects annual growth of 5 percent for NFL income tax collections while statute previously required annual growth of 8 percent. However, even the Authority's projected annual NFL income tax growth of 5 percent appears too high because actual NFL tax collections have increased an average of 2.2 percent annually from fiscal years 2002 through 2008, including new amounts recently identified from 2005 and 2006 tax years that will be paid in fiscal year 2010.

Projected NFL income tax revenues may be too high.

Finally, even if the Legislature had not repealed the State General Fund subsidy and the Authority continued to receive NFL state income tax collections increasing at 8 percent, including any State General Fund monies required to meet that growth requirement, the additional monies would still be insufficient to address the Authority's projected deficits for fiscal years 2009 through 2014. For example, if the 8 percent growth amount were still in place, the Authority would have received a minimum of $6,005,242 in fiscal year 2009. However, the Authority will actually receive approximately $4.2 million from NFL state income tax collections in fiscal year 2009. Although this represents a difference of more than $1.8 million, these additional monies would have only partially offset the Authority's projected deficit of nearly $6.8 million in fiscal year 2009.

Authority's financial decisions have affected costs—In addition to receiving lower-than-expected NFL income tax revenues, several financial decisions that the Authority made have negatively affected facility revenues and expenses, including:

- **Facility construction costs**—The Authority incurred $53.4 million more in multipurpose facility construction costs than originally projected and $32.8 million more than projected in January 2004 when facility design plans were largely finalized. Table 3 shows that the Authority's portion of stadium construction costs was originally estimated at $246 million, but increased to a total of $299.4 million. The increased construction costs, some of which was paid for through the issuance of bonds, increased the amount of monies needed to pay for bond debt service and decreased monies available for operating expenses. According to the Authority, the increased costs of construction materials contributed to the higher construction costs. Additionally, $32.3 million of the increased costs were for site improvements that were originally to be funded by the City of Glendale (City). Instead, to help ensure that facility construction was completed on time, the Authority agreed to finance the site improvements. In turn, according to a 2005 agreement, the City remits to the Authority city sales tax revenue resulting from sales at the multipurpose facility to help repay bonds that the Authority issued to finance the site improvements.

Table 3: Comparison of Projected and Actual Stadium Construction Costs (In Millions) (Unaudited)

	Original Projection	Projection as of January 2004	Actual Costs
Arizona Sports and Tourism Authority's Share	$246.0	$266.6	$299.4
Arizona Cardinals' Share	85.0	104.0	140.3
City of Glendale's Share	0.0	0.0	6.7
Total Construction Costs	$331.0	$370.6	$446.4

Source: Auditor General staff analysis of the Proposition 302 (2000) voter information pamphlet, Office of the Auditor General Report No. 04-01, and cost and funding analysis provided by the Authority as of November 17, 2008.

- **Facility completion costs**—According to the Authority, to fullfill a contract obligation and enhance the operational aspects of the facility, it also paid $9.61 million for facility interior improvements such as extravaganza seating, which is temporary seating that can expand facility seating to 72,200 for larger events such as the Super Bowl; furniture, fixtures, and equipment; and media space and meeting rooms.

- **Reimbursement to the Arizona Cardinals**—The Authority, in its facility-use fee agreement with the Cardinals, agreed to help reimburse the Cardinals for some costs the Cardinals incurred for the facility. The Cardinals contributed $140.3 million to facility costs. The agreement provides for the Cardinals to be reimbursed for contributing nearly $25 million for costs that were not the Cardinals' obligation to pay. However, similar to the site improvements, these costs were originally the City of Glendale's obligation. In order to help ensure the facility was completed on time, the Cardinals agreed to fulfill these obligations. These costs included $4.2 million for facility on-site improvements, $17.8 million for land acquisition, and $3 million for stadium construction. These amounts accrue 5 percent interest annually from fiscal year 2006 until fully paid.

The facility-use fee agreement was established, in part, to generate revenues to help retire the Authority's series 2005A bond debt, but to also reimburse the Cardinals for their additional $25 million contribution. Specifically, the facility-use fee agreement establishes a fee in the price of Cardinals tickets that the Cardinals retain and a fee in the price of other facility event tickets that the Authority retains (see textbox). As specified in the agreement, the Authority will use its facility-use fee revenue to service the series 2005A bond debt, which totaled $53.05 million and will be retired in 2036. Beginning in calendar year 2012, the agreement requires both the Authority and the Cardinals to use the revenue from their respective facility-use fees to begin reimbursing the Cardinals for the $25 million plus accrued interest. However, the Authority is required to use only the excess facility-use fee revenues that it does not need to pay the series 2005A bond debt service to contribute to the Cardinals' $25 million reimbursement. Based on the contributions from their respective facility-use fee revenues that both the Cardinals and Authority will make toward the $25 million reimbursement, the Authority projects that it will pay a total of approximately $15 million, consisting of principal and interest, between fiscal years 2012 and 2020 to help reimburse the Cardinals. The Authority expects that the Cardinals' contributions of their facility-use fee revenues will cover the remaining amount. The Authority's ultimate obligation depends on the revenues generated from its facility-use fees that it can contribute toward the reimbursement, the facility-use fee revenue that the Cardinals contribute to the reimbursement, and the amount of interest that accrues. Despite the eventual reimbursement of its land costs, the Cardinals will retain ownership of the parking area and other land around the facility. The Authority is able to contribute towards this reimbursement because A.R.S.§5-802(C) exempts the Authority from Arizona's constitutional ban on providing gifts. The Authority owns the land the multipurpose facility actually sits on.

Facility-Use Fee—Fee included in the price of each ticket sold for events held at the facility. There is a facility-use fee on Cardinals tickets that the Cardinals retain if not needed to retire the series 2005A bond debt. The Authority's facility-use fee is paid on tickets for authority events and is used to service the Series 2005A bond debt. As of calendar year 2012, the proceeds of both fees, less any amounts needed to retire the series 2005A bond debt, will be used to reimburse the Arizona Cardinals for certain expenses incurred.

Source: Auditor General staff review of the Facility-Use Fee Agreement.

The Cardinals own the parking area and other land around the facility, while the Authority owns the land the facility sits on.

- **Naming rights granted to the Arizona Cardinals**—The Authority's agreement with the Cardinals granted naming rights to the Arizona Cardinals organization, and the Authority does not receive monies generated from the facility's naming rights. The Arizona Cardinals signed a multi-year agreement with the University of Phoenix (University) to become the Cardinals' naming rights partner. The University will pay the Arizona Cardinals organization $154.5 million over the 20-year period ending 2026 in exchange for naming rights, signage, and various advertising, marketing, and merchandising opportunities. According to authority officials, assigning naming rights to the team is a standard industry practice.

The Authority's unreimbursed Cardinals football game day expenses were more than $2.3 million in both fiscal years 2007 and 2008.

Authority is not reimbursed for football game day expenses—The Arizona Cardinals game day expenses contribute to the Authority's higher operating expenses and increasing deficits. Under an agreement with the Arizona Cardinals, approved by the Authority's board of directors, the Authority is responsible for all of the Cardinals game day expenses at the facility, which were more than $2.3 million in both fiscal years 2007 and 2008. The Authority estimates fiscal year 2009 game day expenses at almost $2.5 million, which represents 36 percent of the Authority's projected operating deficit for that year. The Arizona Cardinals pay rent to use the facility, starting at $250,000 for the first year and increasing by 2 percent annually, but the Arizona Cardinals game day expenses far exceed its rental payment. The Governor's Stadium Plan "B" Advisory Task Force (Task Force), which was charged with studying the facility funding options, recommended that the Arizona Cardinals contribute to its game day expenses in exchange for receiving game day revenues. However, under the current agreement, the Cardinals receive game day revenues and the Authority pays all game day expenses. The Authority receives a portion of all sales tax revenues generated at the Cardinals games. Authority officials stated that paying game day expenses for an NFL tenant is common industry practice.

Additionally, the Authority pays a portion of the Fiesta Bowl game day expenses. Originally, the Fiesta Bowl agreed to pay all of its game day expenses. However, in fiscal years 2006 and 2007, the Fiesta Bowl contributed $5.2 million toward the multipurpose facility's interior improvements. As a result of this contribution, the Authority agreed to pay $300,000 of Fiesta Bowl game day costs and expenses commencing in fiscal year 2007 and increasing by 2 percent annually through 2035. The Authority will pay a total of approximately $11.6 million through 2035 for Fiesta Bowl game day expenses, representing an interest rate of 5.7 percent for the Fiesta Bowl contribution. The Authority also receives a portion of all sales tax revenues generated at Fiesta Bowl games.

Event revenues do not cover operating expenses—The Authority hosts various events in the multipurpose facility, but the revenues these events generate do not cover the facility's operating costs. Operating revenues were never expected to cover all operating expenses and it was intended that the Authority's nonoperating revenues would subsidize stadium operations. For example, the Authority estimated in July 2001 that almost $8.2 million in nonoperating revenues would be needed to subsidize operating expenses in the first full year of stadium operations. As illustrated in Table 4 (see page 19), the facility's unrecovered operating expenses, not including the Authority's operating expenses, were approximately $8.6 million in fiscal year 2007 and $9.1 million in fiscal year 2008, as determined from audited financial statements. These unrecovered operating expenses are comparable to estimates prepared in July 2001, 5 years prior to the facility's opening. Several factors contribute to this situation. Specifically:

- **Large operating expenses**—To manage, operate, and maintain a facility such as the multipurpose facility requires considerable resources. As illustrated in Table 4, facility operational expenses totaled $27.84 million in fiscal year 2007 and $22.67 million in fiscal year 2008. The Authority incurred many of these expenses to attract and hold events. Additionally, the Authority receives event revenue, including event promoter reimbursement of some expenses and rental payments, but these revenues and reimbursements only covered nearly 70 percent of operating expenses in fiscal year 2007 and 60 percent of operating expenses in fiscal year 2008. Some examples of large expenses paid through the facility manager in fiscal year 2008 included:

Table 4: Summary of University of Phoenix Stadium Revenues and Expenses From Operations Fiscal Years 2007 and 2008 (In Millions)

	Fiscal Year 2007	Fiscal Year 2008
Revenues	$19.28	$13.60
Expenses	27.84	22.67
Unrecovered Expenses	$ (8.56)	$ (9.07)

Source: Auditor General staff analysis of the Authority's audited financial statements for fiscal years 2007 and 2008.

  - Almost $4.5 million for facility manager personnel costs, including nearly $1.2 million that was allocated to events;
  - More than $2.3 million for contracted security services, including nearly $1.2 million in unreimbursed football game day expenses and approximately $520,000 that was reimbursed by event promoters;
  - More than $2 million for utilities expense; and
  - $584,467 for Glendale police, who support all events. According to the Authority, this amount included $468,000 in unreimbursed football game day expenses and $110,000 that was reimbursed by event promoters

  Additionally, the Authority paid almost $1.2 million for its operations in fiscal year 2008, including personnel costs for its four employees.

- **Events and attendance declining**—The number of events held at the multipurpose facility and the associated attendance at these events significantly declined from fiscal year 2007 to fiscal year 2008. Specifically, during fiscal year 2007, the Authority hosted 179 events at the facility, but only 132 events in fiscal year 2008.[1] This represents a more than 26 percent decline in events. In addition, total attendance at multipurpose facility events declined by 11.8 percent from fiscal year 2007 to 2008. There are at least three apparent reasons why the facility has had difficulty in booking more events. First, according to authority and facility manager officials, event numbers and attendance usually decline after a new facility opens and the newness wears off. Second, the Authority operates in a competitive environment with many other event venues in Maricopa County. This impacts the Authority's ability to attract events. According to authority and facility manager officials, the facility's size is not conducive to some events, including concerts, which prefer

From fiscal years 2007 to 2008, the number of events held at the facility declined by more than 26 percent.

1 The 179 events the Authority hosted in fiscal year 2007 exclude events held in conjunction with the facility's grand opening.

a smaller arena-size facility such as the US Airways Center. Third, the Authority reported difficulty in booking events during the NFL football season when home games occur on the weekends and because of contractually required black-out days before and after the games.

The Authority projects the number of events held at the facility and attendance to further decline in fiscal year 2009 because of the worsening economy. Fewer events and attendance also result in less income from concession commissions and recaptured sales tax receipts. However, the Authority projects that it will host several major events in fiscal year 2010.

- **Most events generate limited net revenue**—Few facility events have provided large amounts of net event revenue, which is total event revenue minus direct event expenses. For example, excluding Cardinals and Fiesta Bowl games, 19 events provided 84.6 percent of total net event revenue in fiscal year 2007, while 18 events provided 72.3 percent of the total net event revenue for fiscal year 2008. Net event revenue for individual events in fiscal years 2007 and 2008 ranged from $782,014 to a net loss of $152,172. Although 39 percent of nonfootball events in fiscal year 2008 provided more than $10,000 each in net event revenue, most events provide contributions of $10,000 or less to overall facility net event revenue.

Individual event net revenue ranged from $782,014 to a net loss of $152,172 in fiscal years 2007 and 2008.

Tourism revenues declining—Economic conditions are beginning to affect revenues the Authority receives from the hotel bed tax and the car rental surcharge. Through fiscal year 2007, these combined revenues had grown by an average of 7.9 percent annually. However, the Authority's combined tax revenues from the hotel bed tax and car rental surcharge declined by almost 1 percent from almost $24.3 million in fiscal year 2007 to less than $24.1 million in fiscal year 2008. Additionally, revenues for the first 6 months of fiscal year 2009 were 3.3 percent lower than for the same period of fiscal year 2008.

Authority should continue efforts to address its financial shortfall

The Authority and its Board of Directors should continue to take steps to address its financial shortfall. As stated in A.R.S. §§5-836(D) and 5-875(C)(4-5), the State of Arizona is not financially liable for any of the Authority's expenses or obligations. According to its projections, the Authority needs more than an average of $4.8 million annually in increased revenues and/or reduced obligations and expenses through fiscal year 2014 just to meet its required obligations and pay for its operating expenses. It needs even more to fund the required reserve accounts. To begin to address its financial situation, the Authority has taken the following steps:

- **NFL income taxes**—In response to requests from the Authority, the Arizona Cardinals have worked with the Arizona Department of Revenue (DOR) to identify an estimated $1,173,000 in additional NFL income taxes that will be paid to the Authority in fiscal year 2010. According to a DOR official, these monies relate to calendar year 2005 and 2006 tax returns for Cardinals' employees. Figure 2 (see page 12) and Table 1 (see page 13) include the impact of this additional revenue.

- **Business plan changes**—At the Authority's November 2008 board meeting, the Board of Directors requested authority staff to work with the facility manager to implement a revised business plan for the operation of the multipurpose facility. This revised business plan would focus on reducing facility expenses, reducing the number of events held at the facility, and attracting only large "mega events" to the facility that would bring in substantial revenues and attendees from outside Maricopa County, in addition to holding Arizona Cardinals and Fiesta Bowl games. Authority staff reported at a January 2009 Board Finance—Budget and Audit Committee meeting that they were working with the facility manager to reduce the facility's operating budget by $1 million for the remainder of fiscal year 2009 and by another undetermined amount for fiscal year 2010.

The Authority is working to revise its business plan to help address its financial situation.

- **Constant maturity swap agreement change**—In January 2009, the Authority's Board of Directors approved a resolution authorizing the Authority to temporarily disable its Constant Maturity Swap (CMS) agreement for a period of up to 3 years. The Authority established the agreement to protect it from potential increases in the interest rate payable on its series 2005A $53.05 million variable-rate bonds. Under the CMS agreement, the Authority pays another party a specified market-indexed interest rate on its bonds, and the other party pays the Authority an amount based on a different market-indexed interest rate. The difference between the two rates provides either a gain or loss to the Authority. As of January 2009, the rate difference was in the Authority's favor and on February 3, 2009, the Authority locked in this difference until February 1, 2011, and received payment of $1,062,000. At the end of this period, the payments will resume as before.

In addition to these steps, the Authority should also consider the following options:

- **Increasing revenues**—Options for increasing revenues include increasing the number of events and associated event income from events held at the multipurpose facility, distributing to the Authority the visiting NFL player Arizona income taxes that statute requires to be collected from NFL football games played in Arizona, increasing the hotel bed tax and/or car rental surcharge, and increasing the amount of the Authority's facility-use fee. A change in any single revenue source may be insufficient to generate the additional revenues needed. Additionally, several of these options for generating additional revenues would require legislative action, and in some cases, voter approval.

- **Decrease expenses**—In addition to its business plan changes, the Authority should continue to review and identify any operating expenses that may be eliminated or decreased without significantly affecting operations. However, the Authority has established a nearly $13.7 million budget for fiscal year 2009 to operate and maintain the multipurpose facility, and it may not be able to sufficiently reduce expenses to address the projected deficit and still adequately operate and maintain the facility.

- **Change existing revenue distributions**—This option would involve either reordering the statutory funding obligations for tourism promotion, Cactus League development, youth and amateur sports promotion, and multipurpose facility operations and/or changing the statutorily required distribution amounts for these purposes. Either change would require the Authority to seek legislative action.

- **Renegotiate facility use agreements**—The Authority could pursue renegotiating the Cardinals agreement to receive payment for game day expenses or increasing the annual facility rent amount and renegotiating the Fiesta Bowl agreement to receive rent for using the multipurpose facility.

Several solutions may be needed to resolve financial situation.

Because one of these options on its own may not sufficiently address the Authority's financial situation, the Authority may want to pursue a combination of them to ensure its continuing financial viability. Additionally, the Authority should also ensure that it has sufficient monies to fund its statutorily required reserves for youth and amateur sports, operations, and multipurpose capital repair and replacement costs.

Recommendations:

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.

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.

FINDING 2

Authority should enhance its oversight of the facility manager

The Arizona Sports and Tourism Authority (Authority) should revise the incentive fee structure for and improve its oversight of the multipurpose facility management contractor (facility manager). The Authority contracts with a management company to provide all aspects of facility management and operations. However, the Authority should revise the incentive fee structure in its management agreement to be more performance-based. In addition, although the Authority provides some limited oversight, it does not monitor several key aspects of the facility manager's performance and should take steps to enhance its oversight of the facility manager.

Authority contracts for facility management, operations, and maintenance

The Authority is responsible for managing and operating the multipurpose facility known as the University of Phoenix Stadium. In order to fulfill this responsibility, in May 2004, the Authority contracted with a facility manager to manage and operate the facility. As outlined in its agreement with the Authority, the facility manager is responsible for all aspects of facility management and operations, including:

The Authority has contracted with a facility manager to manage and operate the stadium.

- **General management and operations**—This includes marketing the facility, scheduling and booking facility events, maximizing the revenues from those events, and acquiring applicable permits, such as local and state permits needed for certain event activities.
- **Managing facility employees**—The facility manager recruits, trains, supervises, and directs the employees needed to operate and maintain the facility. The facility manager employed 55 full-time employees as of June 30, 2008. In addition, the facility manager hires part-time staff, specialists, and/or

subcontractors, as needed, to manage and operate the stadium. According to a facility manager official, the facility manager also hires temporary staff to clean the stadium after an event.

- **Maintenance, engineering, and custodial services**—This includes providing maintenance, upkeep, and custodial services for the facility structure and all related components, such as the retractable roof and retractable field, and the facility electrical, plumbing, and central air conditioning systems. The facility manager may also use vendors or subcontractors to provide these services for the facility.

- **Security and crowd control**—The facility manager is responsible for providing and arranging for security at the stadium at all times, including during facility events. The facility manager has contracted with a security personnel company to provide facility security.

- **Concessionaire management**—In June 2005, the Authority and the Arizona Cardinals contracted with a company to provide concessions at the facility. Rather than oversee the concessions contractor itself, the Authority contracted with the facility manager to oversee the concessionaire and associated agreement.

- **Other facility management and operations activities**—This includes providing all other needed facility management services, such as landscaping, customer surveys, and negotiations with vendors for materials, supplies, and services.

- **Independently administers the facility's bank account**—The facility manager pays all of its expenses incurred in managing and operating the facility directly from an authority bank account that the Authority authorized the facility manager to establish for this purpose. In addition, the facility manager deposits facility-related revenues that it receives into the account. As illustrated in Table 4 (see page 19), in fiscal year 2008, the Authority reported $13.6 million in revenues and that nearly $22.7 million was spent for facility operations.

Authority should establish a more performance-based fee structure

The Authority should revise the incentive fee structure in its management agreement to be more performance-based. The Authority's management agreement includes provisions that provide the facility manager with annual management and incentive fees. However, the incentive fee structure should be more performance-based, similar to stadium management agreements in other states.

Facility manager receives both management and incentive fees—In addition to paying for all facility costs from the Authority's facility bank account, the facility manager also pays itself both a management and incentive fee from this account. Specifically, according to the agreement, the facility manager receives a $200,000 fixed management fee for the first 12-month period beginning in August 2006 that increases annually by $30,000. The agreement also provides for an annual incentive fee that shall not exceed the annual fixed fee. The incentive fee consists of an objective and subjective component that each make up 50 percent of the potential incentive fee. As illustrated in Table 5, the Authority paid $382,250 in management and incentive fees in fiscal year 2007.[1]

Table 5: Management and Incentive Fees Paid to the Facility Manager
Fiscal Years 2007 and 2008
(Unaudited)

Fiscal Year	Management Fees[1]	Incentive Fees Objective	Incentive Fees Subjective	Total Fees
2007	$200,000	$100,000	$82,250	$382,250
2008	230,000	115,000	TBD[2]	TBD

1 According to the management agreement, the Authority shall pay the facility manager a fixed fee of $200,000 for the first 12-month period, $230,000 for the second 12-month period, and $260,000 for the third 12-month period.

2 According to an authority official, the subjective portion of the facility manager's fiscal year 2008 incentive fee was still to be determined (TBD) as of December 2008.

Source: Auditor General staff review of the management agreement and evaluations conducted by the Authority, the Arizona Cardinals, and the Fiesta Bowl to determine the subjective portion of the facility manager's fiscal year 2007 incentive fee and discussions with the Authority.

The facility manager receives the fixed management fee regardless of performance and received all of the available objective incentive fee in fiscal years 2007 and 2008. Specifically, for the objective incentive fee, the facility manager earns a fee equal to 5 percent of all adjusted operating revenue not obtained from Arizona Cardinals and Fiesta Bowl events, up to 50 percent of the management fee. This is regardless of whether these revenues increased or decreased.

Objective Incentive Fee—Equal to 5 percent of the adjusted operating revenues that accrue to the Authority for all events, except for Arizona Cardinals and Fiesta Bowl games and related events.

Subjective Incentive Fee—Amount is determined by the Authority and the facility's two major tenants based on criteria each independently determines. The Authority determines 50 percent, the Arizona Cardinals determine 40 percent, and the Fiesta Bowl determines 10 percent of the total subjective fee award.

Source: Auditor General staff review of the facility management agreement.

The Authority, the Cardinals, and the Fiesta Bowl each independently establish criteria to determine the subjective portion of the incentive fee. The agreement includes general criteria for the Authority's evaluation and requires the Cardinals and Fiesta Bowl to develop criteria they will use to determine their portion of the subjective incentive fee. For fiscal year 2007, the Authority analyzed the facility manager's success in achieving goals related to five components, such as profit/loss and number of events/attendance to determine its subjective fee award. For example, for fiscal year 2007, a portion of the subjective fee was awarded to the facility manager because revenues exceeded budget, expenses were below budget, and the facility manager also exceeded goals for the number of events, number of event days, and attendance.

1 As indicated by Table 5, the subjective portion of the facility manager's fiscal year 2008 incentive fee was still to be determined as of December 2008.

Incentive fee should be more performance based—The Authority should establish a more performance-based incentive fee that is similar to stadium management agreements in other states. In May 2006, the Louisiana Legislative Auditor issued a performance audit report on the Louisiana Stadium and Exposition District, which included an evaluation of the fee structures of six NFL stadium management agreements, including the Authority's agreement.[1] The report found that all six agreements included a base fee and incentive fees. However, Arizona has the only agreement that provides incentive fees based simply on a percentage of revenues. Further, three of the other agreements based their incentive fees on the achievement of specific predetermined operating goals or benchmarks. For example, two provided an incentive fee if actual operating income was greater than or equal to the budgeted operating income. Another agreement required the ratio of revenues to expenses to exceed 53 percent before an incentive fee was awarded.

The Authority is planning to review the incentive fee structure.

According to authority officials, the Authority is planning to review the incentive fee structure. 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 fee structure specified in the management agreement conform to U.S. Internal Revenue Service regulations regarding the private use of a facility financed by tax-exempt bonds, such as the multipurpose facility. These regulations detail acceptable management fee structures for these types of facilities.

Authority should improve its facility management contractor oversight

In addition to establishing a more performance-based incentive fee structure, the Authority should enhance its oversight of the facility manager. The Authority performs some limited oversight of facility manager activities, including reviewing some financial reports, such as financial statements, budgets, and quarterly funding requests for facility operations; and holding monthly meetings with the facility manager to discuss facility management activities, such as scheduled events and facility operations. According to an authority official, the Authority does not require its staff to perform more extensive oversight activities because, in addition to the current monitoring activities that the Authority conducts, the Authority has developed a certain level of trust and confidence with its facility manager as a result of daily interaction with the facility manager's staff. This official also indicated that the Authority is open to considering and implementing additional reviews and oversight to further enhance the current level of facility manager oversight. The Authority should

1 Louisiana Legislative Auditor. (2006). *Louisiana stadium and exposition district - Superdome/Arena management agreement State of Louisiana* (Performance Audit Report - Audit Control #06301565). Retrieved May 16, 2008, from http://app1.lla.state.la.us/PublicReports.nsf/EFB6A92FAC3D8AB086257163006C361F/$FILE/000018B6.pdf

increase its oversight of several key areas of the facility manager's contractual responsibilities. For example:

The Authority should expand its review of the facility manager's expenses.

- **Facility manager's expenses**—Although the Authority approves the facility manager's operating budget and quarterly funding requests, it should expand its review of the facility manager's expenses. The Authority monitors facility manager expenses only at a budgetary and financial statement level, and these reports do not provide sufficient detail to identify potential problems or give a detailed picture of how the facility manager spends its budget. For example, auditors' review of one of the facility manager's payment files identified some expenses that might bear further scrutiny given the Authority's financial situation and the use of public monies to pay these expenses. These included several reimbursements paid to the facility manager's corporate office that, according to a facility manager official, were for corporate employees to travel to the facility to help with big events. According to an Authority official, although it did not pay the personnel costs for these corporate employees, it did reimburse the facility manager for these employees' travel expenses. These included a corporate employee's 2-night stay at a hotel that cost more than $700, which included other hotel expenses; various costly food expenses, such as one meal costing nearly $200, two meals costing more than $150 each, and three meals costing more than $100 each; and alcohol purchased on three separate occasions. According to the facility manager, each of these meals were purchased for several corporate and facility manager employees.

  Some review of facility expense detail would allow the Authority to identify any expenses not needed to efficiently manage and operate the stadium, or any expenses that should be paid by the facility manager's corporate office. This could include a review of monthly check registers and bank reconciliations and a periodic in-depth review of a sample of transactions. This would provide greater assurance that the facility manager's expenses are necessary and reasonable to manage and operate the facility, and that public monies are being used appropriately.

- **Event settlements not adequately reviewed**—The Authority does not review event settlements to determine whether the facility manager is adequately reconciling event settlements. According to a facility manager official, the facility manager performs an event settlement for all facility events, except for Arizona Cardinals games because the Authority pays all the Cardinals' home game day expenses. During the event settlement, the facility manager meets with the event promoter to discuss and determine the amount owed to or by the promoter for the event. According to a facility manager official, the amount owed to or by the promoter is based on the contract with the promoter, revenues collected on the promoter's behalf, estimated costs prior to the event, and any changes to these estimated costs based on actual costs incurred during an event. Changes to the estimated costs can occur based on the actual services needed during an event. For example, the promoter for one event was charged approximately $30,000 instead of the estimated $32,000 because of a change in security staff needed for the event. However, the Authority does not review any associated documentation for individual event settlements to determine if these reconciled amounts are reasonable and appropriate. Instead, it reviews consolidated event statements that report total revenues and expenses by event category for several events, such as trade shows or entertainment events. Although the Authority's external financial auditors test a sample of events to verify the accuracy of event revenues recorded in accounting records, reviewing a sample of event settlements would allow the Authority to better ensure that the facility manager is adequately reconciling event settlements.

The Authority does not consistently ensure necessary preventative maintenance has been completed.

- **Inconsistent preventative maintenance oversight**—The Authority does not consistently ensure that the facility manager has completed necessary preventative maintenance, which can help prevent or reduce expenses to fix and maintain facility equipment and infrastructure, such as air conditioning, plumbing, and electrical systems. Although the Authority discusses preventative maintenance with the facility manager at monthly meetings and received preventive maintenance documentation in April 2008, according to authority officials, the Authority does not periodically review the preventative maintenance schedule or other relevant documentation to ensure that it has been completed. According to the facility manager's Operation and Maintenance Plan, preventative maintenance is one of the most important components of facility management because it protects the facility, ensures smooth operations of events, minimizes costly emergency repairs, and helps protect the safety of attendees. In addition, overseeing maintenance to help ensure that components do not prematurely fail is particularly important because the Authority has not funded any reserves for facility capital equipment repair and replacement. According to an authority official, the Authority does not verify that preventative maintenance has been completed because the facility manager has a vested interest in ensuring that it is done, and if preventative maintenance was not being done, then facility tenants would complain.

- **Box office services not supported by signed agreement**—The Authority has not ensured that the facility manager has established a written contract with the Arizona Cardinals for box office services. The Cardinals operate and provide box office services for not only their games, but all facility events. In July 2006, the facility manager sent a letter to the Cardinals outlining the Cardinals' expected responsibilities for box office services for authority events, such as box office hours and staffing, and reports that must be submitted to the facility manager. According to an authority official, the facility manager pays the Cardinals a $6,000 monthly fee for box office services. However, the facility manager does not have a signed, written agreement with the Cardinals for box office services. Without a written contract for box office services, the Authority cannot ensure that the scope of work, expectations of each party, compensation, and dispute resolution have been adequately defined.

Authority should conduct additional monitoring

Auditors recognize that the Authority's small staff size impacts the extent of the contract monitoring that it can perform. However, even though the Authority has only four staff members, it can and should develop and implement a formal contract-monitoring plan based on the resources it has. This plan should include a process for reviewing monthly check registers and bank account reconciliations. The Authority should also, based on resources available, determine a frequency for sampling revenues, expenses, and event settlements for detailed review; and for reviewing preventative maintenance schedules and documentation of completed maintenance. Finally, the Authority should ensure that the facility manager establishes a written agreement with the Cardinals for box office services.

The Authority should develop and implement a monitoring plan based on available resources.

Recommendations:

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.

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.

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

FINDING 3

Minor improvements needed to better fulfill mission

The Arizona Sports and Tourism Authority (Authority) has taken steps to fulfill its purposes, but it can make some minor improvements to better fulfill its mission. The Authority has met statutory requirements for funding tourism and Cactus League promotion within Maricopa County. Additionally, authority funding has increased the number of youth and amateur sports facilities and programs throughout Maricopa County, but minor improvements can be made to the Authority's youth and amateur sports policies.

Authority funding has facilitated tourism promotion

As required by statute, the Authority distributes monies to the Arizona Office of Tourism (Office) to promote tourism in Maricopa County. The distribution level started at $4 million in the first year beginning in June 2001, increasing by 5 percent annually, and will total almost $265.8 million through fiscal year 2031. In fiscal year 2008, the Authority distributed almost $5.4 million to the Office.

The Authority's statutory responsibility is limited to providing the required amounts to the Office, and it has no responsibility for how the monies are spent and further distributed. The Office has established a grants program to award these monies to organizations promoting tourism within Maricopa County. According to the Office, it retains 5 percent of these monies for its own tourism promotion activities, such as advertising that specifically highlights amenities within Maricopa County and/or media purchased in partnership with other organizations marketing tourism in Maricopa County. Organizations receiving funding must undertake projects that create and implement new or expanded tourism marketing programs that did not exist in fiscal year 2001. Additionally, according to statute, these organizations may not use allocated funding for any administrative costs. Table 6 (see page 32) shows how the Office allocated the Authority's tourism promotion funding in fiscal years

Authority monies accounted for nearly 25 percent of all tourism promotion funding for certain agencies in the past 3 years.

2006, 2007, and 2008. According to information received from the Office, the authority monies accounted for nearly 25 percent of all tourism promotion funding received by those agencies in the last 3 years.

Table 6: Tourism Promotion Monies from the Authority Distributed by the Arizona Office of Tourism Fiscal Years 2006 through 2008 (Unaudited)

Organization	2006	2007	2008
City of Chandler	$ 121,032	$ 144,790	$ 144,380
City of Glendale	237,891	19,305	19,250
City of Peoria		62,742	62,564
Fountain Hills CC[1]	16,694	14,479	19,251
Greater Phoenix CVB[2]	2,512,927	2,460,994	2,691,896
Mesa CVB[2]	204,503	255,796	264,697
Scottsdale CVB[2]	1,231,191	1,341,722	1,352,360
Tempe CVB[2]	313,015	376,454	380,201
Wickenburg CC[1]		193,054	178,069
Arizona Office of Tourism	244,066	256,270	269,088
Total distributions	$4,881,319	$5,125,606	$5,381,756

1 CC—Chamber of Commerce.

2 CVB—Convention and Visitors Bureau.

Source: Auditor General staff analysis of data provided by the Arizona Office of Tourism of authority tourism promotion monies distributed by the Arizona Office of Tourism for fiscal years 2006 through 2008.

Authority funding assists development of the Cactus League

Nearly all projected Cactus League revenues have been committed to projects through 2031.

Authority funding for Cactus League projects has assisted in providing baseball spring training facilities for new teams and to renovate existing training facilities. Statutes allow the Authority to acquire land or construct, finance, furnish, improve, market, or promote the use of existing and proposed major league baseball spring training facilities. Through various agreements and planned future renovations, the Authority has committed a majority of a total available $403.1 million through fiscal year 2031 to either construct new or renovate existing spring training facilities for professional baseball teams as illustrated in Table 7 (see page 33). Statute requires that the Authority provide $205 million in funding for Cactus League development from its hotel bed tax and car rental surcharge revenues through fiscal year 2031, and the Authority projects receiving $198.1 million through fiscal year 2031 from its agreement with the Maricopa County Stadium District (District). Most of these

Table 7: Cactus League Projects Completed or In Progress and Planned Future Projects
Fiscal Years 2002 through 2031
(Unaudited)

Facility	Project Type	Team(s)	Cost (In Millions)
Projects Completed or Underway			
Surprise Stadium	New	Texas Rangers Kansas City Royals	$ 32.0
Phoenix Municipal Stadium	Renovation	Oakland Athletics	4.3
Tempe Diablo Stadium	Renovation	Los Angeles Angels	12.0
Scottsdale Stadium	Renovation	San Francisco Giants	20.0
Goodyear Stadium[1]	New	Cleveland Indians Cincinnati Reds	37.4
Glendale Stadium	New	Los Angeles Dodgers Chicago White Sox	60.0
Planned Future Projects[2]			
Maryvale Baseball Park—2012	Renovation	Milwaukee Brewers	6.8
Peoria Sports Complex—2014	Renovation	Seattle Mariners San Diego Padres	11.2
Phoenix Municipal Stadium—2014	Renovation	Oakland Athletics	3.7
Hohokam Stadium, Mesa—2016	Renovation	Chicago Cubs	8.2
Surprise Stadium—2022	Renovation	Texas Ranger Kansas City Royals	16.5
Estimated project costs			**$212.1**
Estimated financing costs (interest on bonded debt)			**185.5**
Reimbursement to the Authority			**1.8**[3]
Unallocated Maricopa County Stadium District Projected Revenues			**3.7**
Projected revenues available for Cactus League projects through fiscal year 2031			**$403.1**[4]

1 The Authority agreed to provide an additional $30 million for the Goodyear project if Cactus League monies are available after fiscal year 2031 or after all other Cactus League commitments are satisfied.

2 Years for future renovation projects are based on team lease expiration dates.

3 Of this amount, $253,477 is for Cactus League legal and contract costs expended from the authority operating account, and the remaining $1,526,204 reflects a planned transfer from the Cactus League promotion account to the Authority's operating account to recover costs incurred for the abandoned multipurpose facility site in Tempe based on an agreement with the City of Tempe.

4 Consists of $205 million from the Authority and an estimated $198.1 million from the Authority's Intergovernmental Agreement with the Maricopa County Stadium District.

Source: Auditor General staff analysis of the Authority's Cactus League agreements and funding projection spreadsheet.

projected revenues have been committed through fiscal year 2031 to building three new baseball spring training facilities, which has attracted six new teams to the Cactus League, and renovating existing facilities, which will help to retain seven teams. In addition, one newly constructed facility and already-renovated facility are scheduled for future renovations. The Authority contributed funding to renovate the Phoenix Municipal Stadium in 2004 and construct the Surprise Stadium in 2002, and plans to participate in renovations of these facilities in 2014 and 2022, respectively. The Authority expects cities to procure long-term leases from the baseball teams before it will participate in funding new or renovation projects.

The Authority has established appropriate policies for expending Cactus League monies.

Additionally, the Authority has established appropriate policies for expending its Cactus League monies. Although the Authority has entered into several agreements to fund Cactus League projects, the agreements are prioritized and the Authority's funding is contingent upon available revenues. The Authority is not obligated to pay the agreed amounts if its actual Cactus League revenues are insufficient to meet the commitments. The agreements generally prioritize the payments as listed in Table 7 (see page 33), except that future renovation projects have priority over Goodyear and Glendale project payments. Auditors' review of funded applications and agreements found that all projects were funded according to the Authority's criteria of funding one-half of the construction costs for a new one-team facility and two-thirds of the project costs for a new two-team facility. In addition, the Authority limits its total project funding to a fixed maximum contribution amount. For example, the Authority agreed to pay $4.36 million for the Phoenix Municipal Stadium renovation project, not to exceed two-thirds of the total project costs. Statute does not allow the Authority to pay more than two-thirds of a Cactus League project's cost, requiring a local match from the county, municipality, or private sources of at least one-half of the amount paid by the Authority.

According to a survey released by the Cactus League, the Cactus League has a positive tourism impact, and continued league development may increase that impact. The 2007 Cactus League Attendee Tracking and Expenditure Impact Survey reported a significant increase in spring training attendance since its 2003 survey.[1] This study showed that 57 percent of spring training attendees come from outside of Arizona and that more than 68 percent of those visitors came to Arizona primarily for spring training activities. The report estimated that direct expenditures of Cactus League attendees in Maricopa County were $129.3 million in 2007, based upon 120,083 total out-of-area unique travel parties that visited Maricopa County for Cactus League spring training activities.

Authority funding has helped youth and amateur sports

Authority funding has helped increase the number of youth and amateur sports (YAS) projects undertaken in Maricopa County. Specifically, the Authority has awarded more than $11.3 million for 110 YAS projects in Maricopa County. Additionally, the Authority follows its YAS grant application, grant-award criteria, and cost-reimbursement policies and procedures, but these policies and procedures should be updated.

1 Cactus League. (2007). *Cactus league attendee tracking survey.* Retrieved May 23, 2008, from http://www.cactusleague.com/downloads/2007_Cactus_League_Report.pdf

Funding provided for YAS projects—According to authority reports, the Authority has awarded more than $11.3 million in grant funding for 110 YAS projects between fiscal years 2001 and 2008. As required by statute, the Authority must distribute $1 million in the first year beginning June 2001, increasing by $100,000 annually until fiscal year 2031. Consistent with this requirement, the Authority reports providing nearly $8.3 million in funding for 23 new YAS facilities, nearly $2.4 million for 19 facility renovations, more than $390,000 for 13 YAS programs, and nearly $295,000 for transportation, equipment, and uniform costs for 55 associations. Authority-funded projects are in close proximity to public schools per statutory priorities. Table 8 provides examples of projects the Authority funded.

The Authority awarded more than $11.3 million in grant funding for 110 YAS projects.

Table 8: Examples of Projects Funded for Youth and Amateur Sports (Unaudited)

Grant Year	Location	Organization	Award	Project	Project Type
2003	Mesa	Mesa YMCA	$ 65,000	Field lighting	Renovation
2003	Queen Creek	Desert Mountain Park	250,000	Field construction	New construction
2003	Glendale	Glendale Youth Sports Fields	1,000,000	Field construction	New construction
2005	Phoenix	Arizona Recreational Center for the Handicapped	65,000	Sports and fitness park	New construction
2005	Cave Creek	Cactus Foothills North Little League	110,000	Field equipment	Equipment
2005	Phoenix	Boys and Girls Club—Stewart Branch	250,000	Gym renovations	Renovations
2008	Gilbert	Great Hearts Academies	47,025	Sports fields	New construction
2008	Phoenix	Brunson–Lee Elementary School	100,694	Track resurfacing	Renovations
2008	Mesa	YMCA—East Valley	500,000	Pool construction	New construction

Source: Auditor General staff analysis of YAS grant award data provided by the Authority.

Policies for YAS grant awards—The Authority has established and complied with its written policies and procedures governing the YAS grant application, grant-award criteria, and cost-reimbursement processes. According to an authority official, the Authority has established a biennial, rather than an annual grant cycle, to distribute available YAS monies to ensure greater flexibility in the grant award process. Similar to Cactus League projects, YAS grantees must pay a minimum of one-half of the project costs paid by the Authority. Rather than provide monies up front for projects, the Authority reimburses grantees on a pro-rata basis as they incur project costs. Auditors sampled 10 of the 28 grant applications submitted in the fiscal year 2008 biennial grant application cycle. Auditors found that six projects that received funding met application content requirements and funding criteria. The Authority appropriately denied funding to four projects when the projects did not meet application criteria, the applicant did not meet the required funding match, or the applicant did not provide needed information to properly evaluate the grant request. After awarding grants, the Authority appropriately monitored project costs and properly reimbursed grantees for the Authority's participation amount for all grants the auditors sampled.

The Authority should incorporate preferred funding criteria into its written policies and procedures.

The Authority should make some minor changes in written policies and procedures for the YAS program. Although application materials include grant-selection criteria, the written policies do not. Additionally, the Authority's policy requires an outside entity to review grant applications. However, this practice is no longer used, and grant requests are first reviewed by authority staff, then the authority Board's YAS Committee, with the Authority's Board finally approving funding recommendations. The Authority should incorporate preferred funding criteria found in its grant application materials into the written policies and remove the requirement for an outside review of grant applications.

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 YAS grant applications, which no longer occurs.

APPENDIX A

Methodology

Auditors used a number of methods to study the issues addressed in this report. They attended the Authority's June 25, 2008, November 2008, and January 2009 board meetings, and finance committee meetings held in January, June, October, and November 2008, and January 2009; interviewed the Authority's staff, board members, and facility manager staff; and reviewed statutes, the Authority's board meeting minutes, and the Authority's annual budgets. Auditors also reviewed the final report of the Governor's Stadium Plan "B" Advisory Task Force, the Proposition 302 (2000) voter information pamphlet, and a number of authority agreements, including agreements with the facility manager, the Cardinals, the Fiesta Bowl, and the City of Glendale. Auditors also used the following methods:

- To assess the Authority's financial situation, auditors reviewed and analyzed the Authority's revenue and expense projections prepared in October and November 2008. Auditors assessed their reasonableness by comparing them to the Authority's historical financial performance for fiscal years 2002 through 2008 and prior projections prepared for the Task Force, the Proposition 302 (2000) voter information pamphlet, and the Authority's bond prospectuses. Auditors also analyzed the Authority's audited financial statements for fiscal years 2002 through 2008, financial system information consisting of income and expenses for fiscal years 2001 through 2008, budget reports for fiscal years 2002 through 2009, and monthly distribution forms for fiscal years 2006 through 2008. Finally, auditors reviewed and analyzed monthly event reports for August 2006 through June 2008 and reviewed in detail four event files containing invoices and supporting documents for event income and expense items, and six event revenue/expense statements.

- To determine if the Authority has adequate internal controls and processes to oversee facility contractors, auditors reviewed various reports and documents that the Authority receives from the facility management contractor as part of its monitoring activities, including financial statements, consolidated event income statements, and a budget variance report. Auditors then conducted a more detailed review of the facility manager's financial transactions and check registers for fiscal years 2007 and 2008, including one facility manager vendor payment file for fiscal year 2008. In addition, auditors reviewed monthly documents that are required by the agreement, including check registers, bank statements, and bank reconciliations, and attended a monthly oversight meeting between the Authority and the facility manager. Finally, auditors reviewed a performance audit report on the Louisiana Stadium and Exposition District issued by the Louisiana Legislative Auditor in May 2006 and U.S. Internal Revenue Service regulations pertaining to management contracts for facilities financed with tax-exempt bonds.[1]

- To determine whether the Authority fulfills its statutory purposes and has established adequate internal controls to help it fulfill these purposes, auditors reviewed revenue distributions the Authority made to the Arizona Office of Tourism (Office), interviewed an office official, reviewed the Office's fiscal year 2008 application guidelines for requesting funding from authority monies, and reviewed office-prepared spreadsheets summarizing tourism funding that the Office awarded to applicants and the applicants' total tourism marketing budgets. Auditors also reviewed the Authority's agreements to fund new Cactus League facilities or renovate existing facilities with the cities of Surprise, Tempe, Scottsdale, Phoenix, Glendale, and Goodyear; the Authority's policies and procedures for funding Cactus League projects; the Authority's agreement with the Maricopa County Stadium District; and the 2003 and 2007 Cactus League Baseball Attendee Tracking Survey. Finally, auditors reviewed an authority-prepared spreadsheet on all grants it awarded for youth and amateur sports projects from fiscal years 2002 through 2008, the Authority's policies and procedures for processing grant requests and payments, the grant application forms and instructions, and all file documents for a random sample of 10 of 28 grant applications from the fiscal years 2007 and 2008 biennial grant cycle.

- To develop information for the Introduction and Background, auditors gathered and analyzed information from authority-provided financial estimates for fiscal years 2009 through 2014. Auditors also reviewed the Auditor General's 2004 performance audit of the Authority (see Report No. 04-01) and information from various authority agreements, contracts, and other documents, including documents and information posted on the Authority's Web site.

1 Louisiana Legislative Auditor. (2006). *Louisiana stadium and exposition district - Superdome/Arena management agreement State of Louisiana* (Performance Audit Report - Audit Control #06301565). Retrieved May 16, 2008, from http://app1.lla.state.la.us/PublicReports.nsf/EFB6A92FAC3D8AB086257163006C361F/$FILE/000018B6.pdf

AGENCY RESPONSE

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March 13, 2009

Ms. Debra K. Davenport, CPA
Auditor General
State of Arizona
2910 N 44th 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.

FINDING 2
Authority should enhance its oversight of the facility manager

Recommendation 2.1
The Authority should continue with is 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.

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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<u>FINDING 2 - Authority should enhance its oversight of the facility manager</u>

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.

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.

<u>Policies for YAS grant awards</u>

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.

<u>Additional Points of Clarification – Performance Audit</u>

<u>Page 16 – Facility construction costs, Facility completion costs and Reimbursement to the Arizona Cardinals</u>

☑ 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,

Performance Audit Division reports issued within the last 24 months

07-01 Arizona Board of Fingerprinting
07-02 Arizona Department of Racing and Arizona Racing Commission
07-03 Arizona Department of Transportation—Highway Maintenance
07-04 Arizona Department of Transportation—Sunset Factors
07-05 Arizona Structural Pest Control Commission
07-06 Arizona School Facilities Board
07-07 Board of Homeopathic Medical Examiners
07-08 Arizona State Land Department
07-09 Commission for Postsecondary Education
07-10 Department of Economic Security—Division of Child Support Enforcement
07-11 Arizona Supreme Court, Administrative Office of the Courts—Juvenile Detention Centers
07-12 Department of Environmental Quality—Vehicle Emissions Inspection Programs
07-13 Arizona Supreme Court, Administrative Office of the Courts—Juvenile Treatment Programs
08-01 Electric Competition
08-02 Arizona's Universities—Technology Transfer Programs
08-03 Arizona's Universities—Capital Project Financing
08-04 Arizona's Universities—Information Technology Security
08-05 Arizona Biomedical Research Commission
08-06 Board of Podiatry Examiners
09-01 Department of Health Services, Division of Licensing Services—Healthcare and Child Care Facility Licensing Fees
09-02 Arizona Department of Juvenile Corrections—Rehabilitation and Community Re-entry Programs
09-03 Maricopa County Special Health Care District

Future Performance Audit Division reports

State Compensation Fund