ARIZONA SPORTS & TOURISM AUTHORITY

August 26, 2015

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

RE: 2015 Performance Audit 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 (the "Authority") we appreciate the opportunity to respond to the 2015 Performance Audit of the Authority. We commend the professionalism, diligence and hard work of the staff of the Auditor General that we have had the pleasure to work with in the last year.

We are pleased with the overall conclusions of the Performance Audit.

Thank you again for the opportunity to respond to this Performance Audit report.

The response to each of the recommendations by the Authority is attached.

Sincerely,

Tom Sadler
President/CEO

cc: David Eberhart, Chairman, Arizona Sports and Tourism Authority
Board of Directors, Arizona Sports and Tourism Authority

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Arizona Sports and Tourism Authority
Summary Response to Findings and Recommendations – 2015 Performance Audit

Finding 1
Authority's tourism revenues are insufficient to fund all statutorily designated priorities

Authority Response

The Authority has fully funded all of its statutory obligations as permitted by the receipt of its dedicated tax revenues, over which it has no control.

Over the time frame of this performance audit, the Authority has distributed a total of $96,505,000 in tax revenues, including the following: Senior Bonds Debt Service: $34,710,000; Tourism Promotion: $25,869,000; Subordinate Bonds Debt Service: $13,248,000; Cactus League Promotions: $4,074,000; Youth and Amateur Sports: $3,643,000; and Youth and Amateur Sports Reserve.

The majority of the Authority's revenue sources (approximately 90%), come from a variety of sales taxes, income taxes, hotel bed taxes and car rental surcharges. These revenue sources have not kept pace with the original projections when our enabling act was passed by the Legislature. Compounding this fact has been the extreme economic recession that impacted tourism over the last eight years. The Authority felt the impact of the economic downturn, but that impact was further aggravated by several legislative changes to our enabling legislation.

The first legislative change 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 legislative change that has negatively impacted the Authority's financial performance 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 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." Page 28.

Unfortunately, what the Auditor General forecasted in that first performance audit has become reality for the Authority. Not surprisingly, given that all of the revenue sources originally available to the Authority were considered when crafting the funding of the waterfall, the impact of the elimination of the statutory minimum on the Authority's sources of revenues has reduced the likelihood that the Authority can fund all of the statutorily designated priorities each month.

Recommendation 1.1
The Board should take an active role in addressing the issue of insufficient tourism revenue for funding monthly distributions by taking the following actions:

a. Working with authority staff to identify and study various options for addressing the issue; including determining the potential financial impact to each statutory priority for each option;

b. Working with stakeholders and the Legislature to identify which options would be feasible; and

c. Clearly communicating to the Legislature and stakeholders the financial impacts to each funding priority for any recommended options.

<u>Authority Response</u>
The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

<u>Recommendation 1.2</u>
To help ensure that its distribution of tourism revenues is consistent with current statutory requirements, the Authority should:

a. Work with its legal counsel to determine if it can legally correct the errors this report has identified in the Authority's prior distributions and then act accordingly; and

b. Hire an outside contractor to annually review its monthly revenue distributions, including conducting work to determine if the amounts distributed were consistent with its statutory requirements.

<u>Authority Response</u>
The finding of the Auditor General is agreed to and the audit recommendation has been implemented. The Authority has initiated a practice to have the facility management firm review and sign-off on their review of the calculations on a monthly basis. Additionally, the independent financial auditor will review these monthly calculations as part of the annual financial audit of the Authority and include a summary of their review and findings in their report-out to the Authority's Board during their presentation of their audit opinion.

<u>Finding 2</u>
Authority may face challenges funding future operations

<u>Authority Response</u>
The Authority agrees with the Auditor General's conclusion that, to the extent the expenses of the Authority are increased without offsetting revenue increases, the Authority will face challenges funding future operations.

<u>Recommendation 2.1</u>
In order to ensure that it complies with its FUF agreement with the Cardinals, the Authority should:

a. Consult with its legal counsel and work with the Cardinals to determine the correct amount of any required payments between the two parties for fiscal years 2011 through 2014;

b. Continue to conduct the calculations as required by the FUF agreement to determine any future payments between the two parties, including any payments from the Authority to the Cardinals; and

c. Hire an outside contractor to annually review its calculations related to the FUF agreement to identify potential errors.

Authority Response

2.1 a. *The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The Authority has worked with legal counsel to prepare a simplified procedure to be followed pursuant to the FUF agreement.*

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

2.1 c. *The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The Authority has initiated a practice to have the facility management firm review and sign-off on the calculations each year at the time the calculations are performed. Additionally, the independent financial auditor will review the calculations as part of their annual financial audit of the Authority and include a summary of their review and findings in their report-out to the Authority's Board during their presentation of their audit opinion.*

Finding 3

Authority should consider various options for improving facility management agreement

Authority Response

The Authority agrees with the conclusion of the Auditor General that the Authority should consider all options to obtaining the best management agreement possible. The Authority has already engaged in that endeavor, by contracting with an expert in the field of stadium management, to help guide the Authority in the process of setting forth the requirements, procuring and evaluating bids and selecting a stadium manager. The Authority is considering ways to encourage and incentivize the need to balance the desire to control costs, increase revenues and maintain a state-of-the-art facility for events. The Authority also agrees with the Auditor General's finding that, notwithstanding what might be considered the best economic deal for the Authority, the management agreement will have to be compliant with IRS regulations.

Recommendation 3.1

The Authority should consider various options for improving its facility management agreement as follows:

a. If the Authority chooses to enter an agreement with a fixed price for any services, whether the agreement is a fixed-price agreement or an agreement with a mixture of a fixed-price and cost-reimbursement components, it should take additional steps to design an effective agreement, including:

  - Increasing performance incentives to compensate the facility management contractor for assuming more risk;
  - Incorporating incentives and/or disincentives for nonfinancial performance in its agreement; and
  - Including its subjective fee evaluations to be completed by the Cardinals and the Fiesta Bowl to help determine a performance-based incentive fee.

b. If the Authority chooses to enter an agreement with cost reimbursement for any services, whether the agreement is a cost the agreement is a cost-reimbursement agreement or an agreement with a mixture of a fixed-price and cost-reimbursement components, it should take additional steps to appropriately design and oversee an effective agreement, including:

- Enhancing its oversight of the facility management contractor's expenses;
- Including a revenue guarantee that meets the Authority's needs; and
- Better aligning facility revenue and expenses in the facility's annual budget.

Authority Response

The finding of the Auditor General is agreed to and the audit recommendation has been implemented. The Authority implemented this process prior to the release of this report by retaining the stadium management expert.

Recommendation 3.2

The Authority should work with its consultant to procure and negotiate the most beneficial agreement possible by:

a. Designing the agreement to help ensure that the Authority's facility-related revenues can pay for its administrative and operational expenses;

b. Incorporating into the agreement and/or establishing sufficient mechanisms to adequately oversee its facility management contractor and ensure that the Authority is receiving the highest quality service for the lowest possible costs; and

c. Ensuring the agreement is consistent with any of the Authority's other agreements.

Authority Response

The finding of the Auditor General is agreed to and the audit recommendation has been implemented. The Authority implemented this process prior to the release of this report by retaining the stadium management expert and working with its legal counsel.

Recommendation 3.3

The Authority should work with its legal counsel to ensure that the new agreement complies with IRS regulations for tax-exempt facilities.

Authority Response

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

Finding 4

Authority should improve its facility capital improvement practices

Authority Response

The Authority agrees with the Auditor General's finding and has already implemented many improvements. The Authority just recently had the money to invest in necessary capital improvements and, given that the facility is a relatively new building, saw the need for such improvements. We agree that is a prudent management technique to provide for a long range plan of these expenditures.

Recommendation 4.1

To help ensure the sustainability and viability of the facility, the Authority and its Board should develop and implement capital planning policies and procedures that include:

a. A clear definition of what constitutes a capital improvement project, including but not limited to significant capital maintenance projects;

b. Provisions for the Board's monitoring and oversight of capital improvements planning and budgeting to help ensure a clear decision-making process, including a description of how the Board will prioritize and approve projects, and a description of the roles and responsibilities in the process for authority staff, the facility management contractor and facility tenants;

c. Provisions for developing a multiyear capital improvement plan (capital plan) covering a period of at least 3 to 5 years that clearly identifies capital and major equipment needs, maintenance requirements, funding options, and operating budget impacts; and

d. Provisions for developing a capital improvements budget as part of its annual budget process using the information in the capital plan to help separately budget and track capital projects. The budget should include a schedule for completing each project, including specific project phases, estimated funding requirements for the upcoming year(s), and planned timing for acquisition, design, and construction activities.

Authority Response

The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The Authority has already implemented this recommendation in part, as noted by the Auditor General.