

OFFICE OF THE CITY AUDITOR

PERFORMANCE AUDIT OF REUNION ARENA



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Memorandum



CITY OF DALLAS

August 20, 2004

Honorable Mayor and Members of the City Council
City of Dallas

We have conducted a performance audit of Reunion Arena (RA) administered by the Department of Convention and Event Services (CES).

As a result of our inquiries and analysis, we conclude that:

- Procedures used to identify, promote and attract events and users are adequate, but are hampered by the Center Operating Company (COC) contract restrictions and Reunion Arena's detachment from the Convention Center. These restrictions inhibit RA's inability to maximize revenues. Based on year-to-date amounts, RA is projected to lose \$1.3 million for FY 2003-04.
- The viability of alternative uses was explored in an independent study prior to RA operating as an ancillary convention facility and a second downtown venue for events, and it was determined that the alternative uses were not economically viable options.
- Sufficient and competent personnel are assigned for RA operations; however, RA budgets did not reflect some relevant expenditures.

Our concerns are discussed in the Opportunities for Improvements section.

We appreciate the cooperation of City staff during our examination.

Thomas Taylor

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c: Mary K. Suhm, Interim City Manager

PERFORMANCE AUDIT OF REUNION ARENA

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INTRODUCTION

We have conducted a performance audit of Reunion Arena (RA) administrated by the Department of Convention and Events Services (CES). We conducted this audit under the authority of Chapter IX, Section 2 of the Dallas City Charter and in accordance with the Annual Audit Plan approved by the City Council.

Scope and Methodology

We performed our audit in accordance with generally accepted government auditing standards and included tests of the accounting records and other audit procedures that we considered necessary in the circumstances. This audit was limited to a review of RA operations. Our audit covered October 1, 2002 through April 30, 2004, although we examined certain events and transactions occurring before and after that period.

The objectives of our audit were to determine whether:

- Procedures used to identify, promote, and attract events and users are adequate;
- Alternative uses have been explored and their viability evaluated; and
- Sufficient and competent personnel are assigned.

To develop an understanding of relevant control structure policies and procedures, we reviewed the financial records, applicable laws, ordinances, contracts, requests for proposals and prior studies. Additionally, we interviewed the management and staff at CES, American Airline Center (AAC), and the Dallas Visitors and Convention Bureau (DVCB). We examined departmental reports, compared data from various reports, observed operating procedures, and analyzed historical results.

Overall Conclusion

As a result of our inquiries and analysis, we conclude that:

- Procedures used to identify, promote and attract events and users are adequate, but are hampered by the Center Operating Company (COC) contract restrictions and Reunion Arena's detachment from the Convention Center. These restrictions inhibit RA's inability to maximize revenues.
- The viability of alternative uses was explored in an independent study prior to RA operating as an ancillary convention facility and a second downtown venue for events, and it was determined that the alternative uses were not economically viable options.
- Sufficient and competent personnel are assigned for RA operations; however, RA budgets did not reflect some relevant expenditures.

Our concerns are discussed in the Opportunities for Improvements section.

INTRODUCTION

Background

RA, a City of Dallas facility with a 19,000 seat capacity and amenities, began operations on April 28, 1980. The facility has continued to host indoor venues in the sports and entertainment industries.

On October 2, 1997, the Dallas Stars (professional hockey team) and Dallas Basketball Limited (Mavericks, a professional basketball team) submitted to the City a Letter of Intent regarding the proposed development, construction, operation, and financing of a new indoor sports arena in downtown Dallas. The City Council passed a resolution approving the Letter of Intent and authorized the preparation of a Master Agreement between the City, the Stars, and Dallas Basketball Limited.

In 1994, a feasibility study stated the Dallas market would not fully support two major arenas and that RA faced significant reduction in the number of events, revenues per event, and operating income, if RA continued to operate after a new arena was built. The study concluded that the impact of a new arena would result in a net operating loss of approximately \$2.3 million per year for RA.

A \$125 million bond issue agreement was reached for the financing of a new arena, American Airlines Center (AAC). Upon construction, the City was to lease the new arena to the COC for a 30-year term and for an annual rental of \$4.4 million (commencing upon occupancy, AAC opened July 2001). Of this amount, the COC agreed to deposit \$1 million per year of the rental payments to the City into a depository account. This account is dedicated for repairs and improvements, and capital expenditures that exceed \$10,000. The COC assumed responsibility for all maintenance and operating expenses of the new arena.

The COC entered into a five-year agreement with the City for management of RA, effective July 28, 1998. The management agreement included a termination provision requiring 60 days notice. On July 16, 2002, the COC, citing fiscal losses, served the City notice terminating the agreement, effective September 30, 2002.

Effective October 1, 2002, the City resumed management of RA. Budgeted expenditures for FY 2002-03 were \$3,498,300. This budgeted amount reflected the impact of COC's advanced bookings of events at RA. Without these advanced bookings and with fewer events, the budget amounts for FY 2003-04 were reduced to \$1,853,667 for expenditures and \$747,545 for revenues.

A section of the 30-year lease agreement between the City and the COC (Lessee) also restricts the use of RA. This agreement prohibits the City from using RA for any purpose that could be economically competitive with the AAC, without first having notified the COC in writing of any such proposed use (within 15 days following receipt of such request). The City may host the event only if the COC declines to pursue the event, (in essence, rights of first refusal).

OPPORTUNITIES FOR IMPROVEMENT

We identified certain policies, procedures, and practices that can be improved. Our audit was not designed or intended to be a detailed study of every relevant system, procedure, and transaction. Accordingly, the opportunities for improvement presented in this report may not be comprehensive of the areas where improvements may be needed.

1. Factors Inhibit Reunion Arena's Ability to Maximize Revenues.

Based on year-to-date amounts, RA is projected to lose \$1.3 million for FY 2003-04. CES is operating RA with the goal of using it as an ancillary facility to the DCC and as a second downtown venue. To date, RA's use as an ancillary facility to the DCC has been limited.

We interviewed staff of CES and DVCB concerning RA's use as an ancillary facility to the DCC. The individuals interviewed agreed that RA's effectiveness as an ancillary facility to the DCC is hampered by its detachment from the Convention Center building. Currently, conventioners would have to be transported (i.e., using busses, shuttles, or other services) from the convention site to RA for coordinated events such as opening ceremonies, general assemblies, etc. The decision to connect RA to the DCC is influenced by the cost of the endeavor and whether the connection will enhance usage. Although the cost of connecting RA to the DCC can be estimated, its enhanced usage after connection is unknown. Additionally, the site of the proposed Dallas Convention Center Headquarters Hotel will more than likely affect the cost, design, and path of any connection between RA and the DCC. It is planned that a convention center headquarters hotel site will be determined by City Council by mid-year 2004.

Reasonable efforts should be employed to maximize the effective utilization of assets. However, the contract (30-year lease agreement) with COC and its right of first refusal hampers the City's ability to schedule events and maximize revenues. The lack of a physical connection between DCC and RA is also a deterrent for booking convention-type events in conjunction with DCC. These factors will continue to negatively impact RA's usage and will make it difficult for RA to maximize revenues.

We recommend the Director of CES determine whether to continue operating RA in light of the restrictions imposed by the right of first refusal. If operations are to continue, determine the feasibility of connecting Reunion Arena to the Convention Center.

OPPORTUNITIES FOR IMPROVEMENT

Management's Response:

On August 21, 2002, the Dallas City Council was briefed on "Reunion Arena Options" and approved the staff recommendation of using Reunion Arena as an ancillary facility to the Convention Center and a second downtown venue for events based on indirect benefits to the City to include additional hotel nights, sales tax revenues from restaurants and shopping. Since then, Reunion Arena has successfully attracted and hosted a variety of high profile sports/entertainment events along with convention meeting-type groups, most of whom would not have been able to choose Dallas as their destination with the availability of our arena facilities.

Reunion Arena has twice hosted the Women's portion of the Big 12 Basketball Tournament with an overall estimated \$30M economic impact, the U.S. Figure Skating Championships with an estimated \$20M economic impact, eighteen (18) Dallas Sidekicks for each of the last two seasons, eight (8) Dallas Desperados Arena football games, and the NCAA Volleyball Final Four Tournament with an estimated economic impact of \$1M. Stand alone groups attracted to Dallas and Reunion Arena include America's Best Dance and Cheer, Family Life Conference & Seminar, Baptist Youth Conference, Stand/Promise Keepers, United Pentecostal Church, Joyce Meyer Ministries and Teen Ministries. Reunion Arena has also been used in conjunction with the Dallas Convention leases such as The Great American Trucking Show, Wal-Mart/Sams, Texas Nurserymen Landscaping Association, International Association of Fire Chiefs and Dallas Auto Show. The CES department continues to seek bookings for Reunion Arena that will not conflict with the right of first refusal currently held by the Center Operating Company. Recent major event bookings include the 2005 1st and 2nd Round Regional games of the NCAA Women's Basketball Tournament and the inaugural season of the World Hockey Association's Dallas franchise which begins a 38 home game regular season schedule this November.

There is a potential opportunity to explore connection between Reunion Arena and the Dallas Convention Center with the convention headquarters hotel project. The feasibility of such would be contingent upon the location of the convention center hotel. If the hotel is located on the Reunion Arena garage, the connection could be part of the planned construction costs.

2. The RA budget does not include all relevant expenditures.

RA's budget significantly understates salaries. In addition, event support staff salary expenses are not included in RA's budgeted expenditures. For RA events, management uses DCC employees for support and setup activities. However, anticipated charges for these services are not incorporated in the annual budget.

The following table shows a comparison of the budgeted to actual/projected salaries for FY 2003 and FY 2004.

OPPORTUNITIES FOR IMPROVEMENT

Item	Budget FY 2003	Actual FY 2003	Difference	%	Budget FY 2004	Projected FY 2004	Difference	%
Salaries	\$385,500	\$633,851	\$248,351	64.4	\$379,420	\$536,446	\$157,026	41.4

As shown in the table above, actual/projected salaries for FY 2003 and FY 2004 were 64.4% and 41.4% more than amounts budgeted for salaries for FY 2003 and FY 2004, respectively. The estimated amount for support staff salary expense has been \$60,000, thus RA-only salaries have been understated by \$188,351 (52%) and \$97,026 (26%) for FY 2003 and FY 2004 respectively. Budgets should include all relevant estimated expenses.

Management should be provided all relevant financial information in making decisions regarding funding and operating RA.

We recommend the Director of CES ensure that future RA expenditure budgets include amounts that approximate historic results.

Management's Response:

In FY 03-04, Reunion Arena is budgeted for seven Full Time Equivalent (FTE's). However, Reunion Arena relies on Convention Center employee support for set-ups, HVAC, electrical and plumbing needs. The Convention Center is reimbursed for these expenses. For FY 2004-05, a \$223,246 increase in the Reunion Arena personnel budget has been requested to more accurately reflect labor expenses.