

March 17, 2003

Mr. Walter Overton, Executive Director, Metropolitan Sports Authority
Metropolitan Sports Authority Board of Directors
Suite 417
222 2nd Ave. North
Nashville, TN 37201

Report of Internal Audit Section

Dear Mr. Overton and Sports Authority Board Members:

We have recently completed a performance audit of the Gaylord Entertainment Center. According to the *Government Auditing Standards* issued by the Comptroller General of the United States, “a performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision making by parties with responsibility to oversee or initiate corrective action.” A performance audit is different than a financial statement audit, which is limited to auditing financial statements and controls, without reviewing operations and performance. In performing this audit, we retained KPMG to work under our direction. Their final report dated February 2003, *Performance Audit of the Gaylord Entertainment Center*, accompanies this letter and is hereby submitted to you.

The Gaylord Entertainment Center (GEC) is owned by the Metropolitan Government of Nashville and Davidson County (Metro) through its component unit, the Metro Sports Authority (Authority). Metro issued bonds to finance construction of the GEC and the Authority oversees its operations. Although the Authority is a distinct legal entity, Metro would be held financially responsible if the Authority were to default on any of its debt. In the event of dissolution, Metro would receive title to all of the Authority’s assets, including the GEC.

The GEC is currently managed under contract by Powers Management LLC (Powers). Powers is owned by the majority owners of the Nashville Hockey Club Limited Partnership (Predators). The Predators, a National Hockey League team, are the primary tenants of the GEC and occupy it under a long-term license and use agreement expiring in 2028.

Although the initial planning of the facility indicated that the GEC would operate at a financial breakeven point by its third year of operations, this has not occurred, and the operating subsidy continues to grow. The actual operating subsidies transferred from Metro's General Fund to the GEC for fiscal years ending June 30, 1999 through June 30, 2002 were as follows.

<u>Year Ended</u>	<u>Operating Subsidy</u>
June 30, 1999	\$1,947,214
June 30, 2000	3,451,809
June 30, 2001	4,165,420
June 30, 2002	5,043,563

The budgeted operating subsidy for fiscal year ending June 30, 2003 is \$5,339,900. Additional background information is contained in the KPMG report.

Objectives, Scope, and Methodology

This audit was performed by KPMG's Convention, Sports and Entertainment Practice (KPMG) under our direction. The audit included jointly designed tests and procedures and utilized KPMG's specialized industry experience and knowledge.

The scope of the work included analyses of various areas and issues, including financial management, facility utilization and marketing. The operations of the GEC were also benchmarked against comparable peer facilities.

The primary objectives of this performance audit were as follows.

- Review all areas of operations of the GEC to: (1) Determine Powers' compliance with the Operating and Management Agreement, and (2) Assess the level of financial performance, especially regarding revenue maximization and expense control.

- Analyze the License and Use Agreement with the Nashville Hockey Club Limited Partnership (agreement) to: (1) Determine the level of compliance by the Predators, (2) Assess the effect of the terms of the agreement on the financial operating results of the GEC, and (3) Compare the terms of the agreement to selected comparable peer teams.
- Perform comparative analyses of the operations and financial results of the GEC to identified comparable peer public assembly facilities.

The methodology employed throughout this audit was one of objectively reviewing various forms of documentation, including written policies and procedures, financial information and various other forms of data, reports and information maintained by the Sports Authority, Powers, and central Metro departments. Management, administrative and operational personnel from Powers and the Sports Authority, as well as personnel from other Metro departments and other stakeholders, were interviewed, and various aspects of GEC operations were directly observed. Data obtained from the various sources were analyzed, and various aspects of performance, cost and practices were compared to those of peer facilities and industry norms.

We performed the audit procedures in accordance with generally accepted government auditing standards.

Findings and Recommendations

The operations of the GEC are complex and are significantly impacted by existing contractual agreements. The KPMG report addresses complex issues and includes detailed information on analysis performed as well as detailed findings and recommendations. The KPMG report should be reviewed in its entirety to gain an understanding of the audit process and the findings and recommendations.

Following is an overview of some of the more significant findings and recommendations included in their report.

- In the short-term, there appear to be limited opportunities for Powers to significantly increase revenues and /or minimize expenses and materially impact the operating deficit. Specifically, the GEC's rental rate structure is consistent with comparable facilities and the overall number of performances and total attendance compare favorably to profiled peer facilities. Considering reasonable differences in the use of contract services, the GEC's management organization, staffing levels and salary and benefit expenses appear to be consistent with other similar facilities. Overall, the GEC appears to be well run.

- The assignment of all management and operational rights of a facility like the GEC to a professional management company and subsidizing any resulting operating deficit is not uncommon. However, Metro's case is unique in that the facility management company and the primary sports tenant share common ownership while Metro is responsible for any operating deficit. For other public arenas managed by an outside facility operator where there is common ownership between the team and the facility operator, the facility operator assumes the risk of any operating losses and benefits from any financial gain.
- A comparison of lease terms between tenant teams and selected peer facilities indicated that the Predators have relatively favorable terms, particularly with regard to revenues from premium seating and the sale of facility naming rights. An analysis of the effect of lease terms on the operating results of the GEC indicates that if the Predators' lease terms were similar to those of the major professional sports tenants at peer facilities, the operating results of the GEC for fiscal year 2001 could have been improved by \$1 million to \$5.8 million. In the only case where the lease revenue would not be increased under a peer's tenant team lease agreement, the management company and the team have common ownership, as with Powers and the Predators, but the management company is responsible for funding any operating deficit.
- KPMG recommended that that Sports Authority take a more active role in strategic planning and oversight of the GEC and that both the Sports Authority and Metro's Finance Department should improve communication and coordination around monitoring financial results of the GEC's operations and around Powers' and the Predators' compliance with agreements in place.

KPMG's overall conclusion was that the Predators and Powers appear to be operating in compliance with the material terms of their respective agreements, and Metro's General Fund operating subsidy to the GEC is in large part the result of the existing contractual agreements with Powers and the Predators. Without renegotiation of existing agreements, significant decreases in the General Fund operating subsidy to the GEC are unlikely. Additional findings and recommendations can be found in the KPMG report accompanying this report.

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Management's response to the audit recommendations is attached to this report.

We greatly appreciate the cooperation and help provided by all Sports Authority and Powers staff.

This report is intended for the information of the management of the Metropolitan Government of Nashville and Davidson County. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Internal Audit Section

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Internal Audit Manager

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