



CITY AUDITOR'S OFFICE

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# Tournament Players Club Lease Agreement

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June 7, 2013

AUDIT REPORT NO. 1309

## CITY COUNCIL

Mayor W.J. "Jim" Lane  
Vice Mayor Suzanne Klapp  
Virginia Korte  
Robert Littlefield  
Linda Milhaven  
Guy Phillips  
Dennis Robbins





June 7, 2013

Honorable Mayor and Members of the City Council:

Enclosed is the audit report, *TPC Lease Agreement*. An audit of a selected City lease agreement was included on the City Council-approved FY 2012/13 Audit Plan. After evaluating several leases, we selected the Tournament Players Club (TPC) Lease and Management Agreement for the audit.

This audit found that the TPC Scottsdale's reported revenues and rounds were relatively accurate, but we identified potential unreported revenue related to complimentary golf rounds provided to employees or for promotional/marketing purposes. Additionally, an amount required by a 1995 Lease amendment to be added in the rent calculation has not been included. As well, contract administration can be improved to ensure compliance with all contract terms.

We would like to thank the City's Public Works and Community Services divisions, as well as the TPC Scottsdale staff for their cooperation and assistance throughout the course of this audit.

If you need additional information or have any questions, please contact me at (480) 312-7867.

Sincerely,

Sharron Walker, CPA, CFE  
City Auditor

**Audit Team:**

Lai Cluff – Senior Auditor  
Joanna Munar, CIA – Senior Auditor



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## EXECUTIVE SUMMARY

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This audit of a selected lease agreement was included on the Council-approved FY 2012/13 Audit Plan. After evaluating 6 major leases, we selected the Tournament Players Club (TPC) Lease and Management Agreement for the audit.

The *Tournament Players Club Lease Agreement* audit focused primarily on FY 2011/12 and 2012/13 rent payments and Basin Management Fund fees. Additionally, compliance with other key contract provisions was reviewed.

Our audit found that the revenue reports submitted by TPC Scottsdale with its quarterly rent payment, including rounds details to support Basin Management Fund surcharges remitted, are relatively accurate. The timing of certain accounting entries made by the TPC Scottsdale's corporate office, along with other minor errors made during the rent calculation, caused small dollar exceptions totaling approximately \$3,600.

However, the value of complimentary rounds given to TPC employees or for promotional/marketing purposes is not specifically addressed by the Lease Agreement and was not included in revenues or the rent calculations. Approximately 7% to 8% of the TPC's total rounds played in calendar years 2011 and 2012 and the first quarter of 2013 were complimentary rounds with no fees charged. For this period, we estimated the value at \$2.1 million, which would equate to \$239,000 in rent and surcharges to the City.

Additionally, an amount required by a 1995 Lease amendment to be added to the rent calculation has not been included. The TPC Scottsdale indicated this amount may have been added to repay the City for a land purchase that was subsequently repaid directly rather than through the Lease Agreement. However, at this time, records are not available to substantiate the reason why this amount is not being included. As a result, it appears rent has been underpaid by about \$11,000 for the last 2-1/4 years alone.

As well, contract administration oversight over lease payments and compliance with other contract terms can be improved. Specifically, verification of TPC-reported revenues is needed, rate increases have not been appropriately approved, the priority reservation restrictions are not monitored, handling of rent payments is inefficient and increases the risk of loss, and capital projects funded by BOR-approved TPC Scottsdale surcharges have not been tracked.





## BACKGROUND

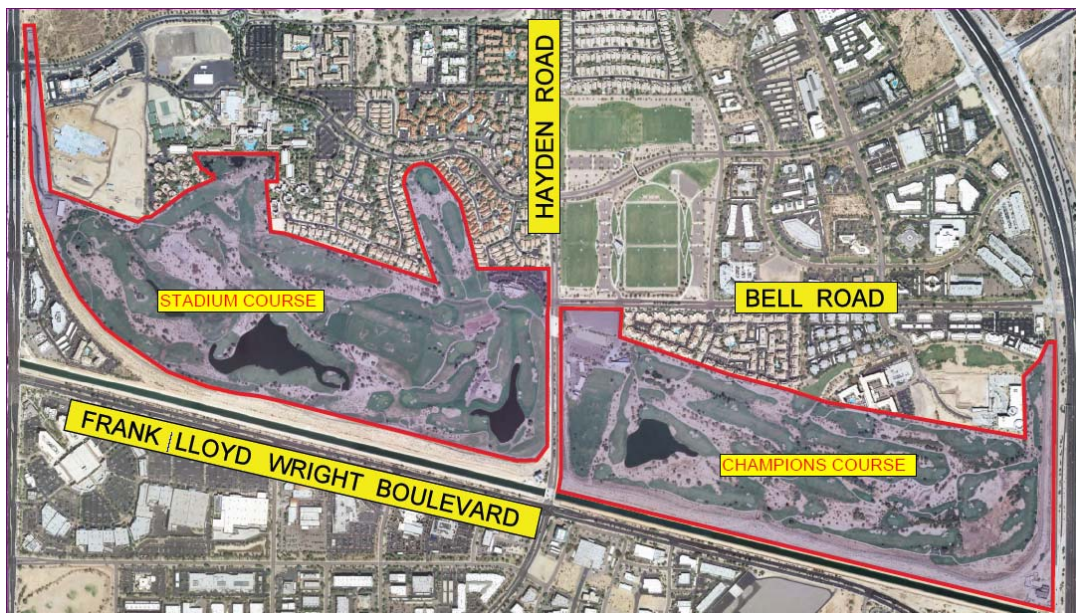
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In December 1984, the City entered into a 50-year lease and management agreement (Lease Agreement) with the Tournament Players Club of Scottsdale, Inc. and PGA TOUR, Inc. to operate the City golf facility now known as the TPC Scottsdale.<sup>1</sup> The Lease Agreement has gone through a series of amendments, with the most recent approved by Council in December 2012. (The lease amendments are summarized in Figure 2 on page 5.) The initial term of the contract extends to 2035, with the TPC having a 25-year renewal option.

As illustrated in Figure 1 below, the leased golf facility is located north of Frank Lloyd Wright Boulevard between Scottsdale Road and the 101 freeway. The property's two golf courses, Stadium and Champions, sit on approximately 400 acres of land bisected by Hayden Road.

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Figure 1. Tournament Players Club of Scottsdale



SOURCE: Aerial prepared by Capital Project Management.

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The City uses this land through a Recreational Land Use Agreement with the federal government's Bureau of Reclamation (BOR Agreement), and the TPC Lease Agreement is also subject to the BOR Agreement terms. In 1986-87, as part of the Lease Agreement, the City designed and built the two 18-hole golf courses with a clubhouse for each course. While the Stadium Course was designed to be a "tournament" course and the Champions Course was intended to be a municipal course, both are open to the public.<sup>2</sup> The Stadium clubhouse was built on City-owned land, but the majority of the 2-course facility is situated on BOR land.

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<sup>1</sup> The TPC Scottsdale is a subsidiary of the PGA Tour Golf Course Properties, Inc., a subsidiary of PGA TOUR, Inc. (PGA TOUR).

<sup>2</sup> The Champions course was initially known as the Scottsdale Course and later changed to the Desert Course before being renamed as Champions.

Around the same time, to provide a complete tourist destination, the City leased City-owned land adjacent to the Stadium Course for the Fairmont Scottsdale Princess.

In addition to the TPC's golf course management, the Lease Agreement also guaranteed the City that the PGA TOUR would hold one of its annual tournament events at the facility for 10 years or longer at the option of the PGA TOUR. Amendment 4 extended this commitment for another 10 years, but that term ended in 2006. Through the recently approved Amendment 6, the PGA TOUR extended its commitment to hold an annual tournament at TPC Scottsdale through 2022. This tournament, currently held annually at TPC Scottsdale in late January or early February, is described as the PGA TOUR's best-attended event. The Phoenix Open has been hosted by the Thunderbirds, a local charitable organization, since 1939. Waste Management currently serves as the title sponsor.

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*According to a recent economic study by the Arizona State University W.P. Carey School of Business, attendance at the 2012 Waste Management Phoenix Open was 518,262 and the economic impact to the Valley was \$222 million.*

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### FINANCIAL TERMS

The Lease Agreement's terms require the TPC to pay as rent to the City 10% of golf course income. The lease defines this as including greens, cart, and driving range fees and all other monies otherwise received by TPC in connection with the use, occupancy or operation of the golf courses.<sup>3</sup> In addition, the TPC pays the City 2% of sales made at the pro-shop and through food and beverage operations.

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*SOURCE: 2012 Waste Management Phoenix Open Economic Impact Study.*

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In December 2012, the Council approved \$15 million in funding for improvements to the Stadium Course and clubhouse in exchange for an extended PGA tour event commitment with national television coverage guaranteed and payment of an increased percentage of golf course revenues. As part of Amendment 6 to renovate the Stadium Course and clubhouse, the TPC agreed to increase the golf course income percentage from 10% to 12.5% beginning in January 2014.

TPC lease payments during the 5-year period of Fiscal Years (FY) 2007/08 through 2011/12 averaged \$931,813 per year. Through the third quarter of FY 2012/13, year-to-date lease payments of more than \$728,000 have already exceeded the \$675,000 average for the same period of the past 5 years.

(continued on page 6)

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<sup>3</sup> Specifically excluded from TPC golf course income are sales taxes and other taxes collected, revenue for golf lessons provided by TPC employees, TPC National Membership fees, sales income and revenue related to the clubhouse.

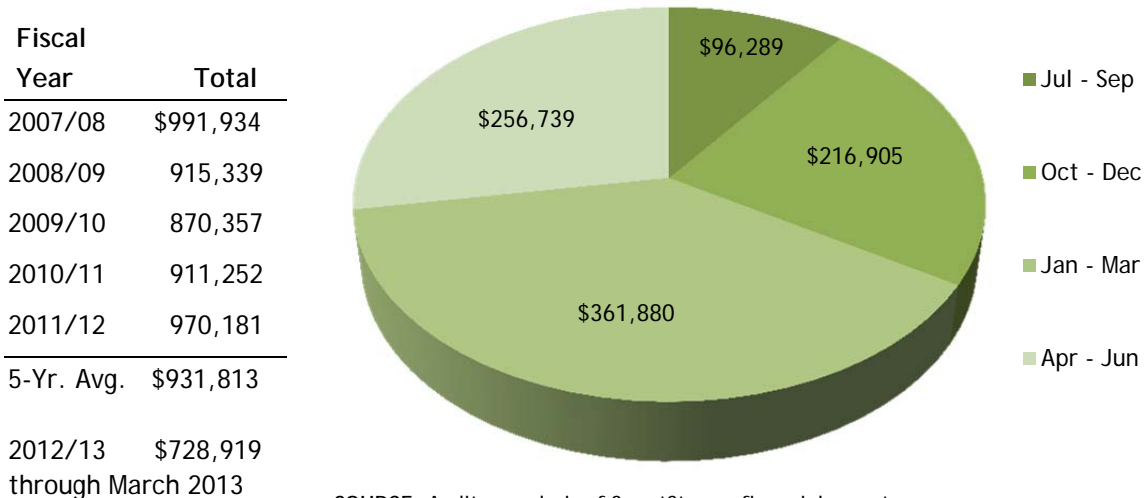
## Figure 2. TPC Agreement Amendments

<b>Dec 1984 - Original</b>
<ul style="list-style-type: none"><li>• Lease and Management Agreement signed between the City of Scottsdale, Tournament Players Club of Scottsdale, Inc., and PGA TOUR, Inc.</li></ul>
<b>Nov 1986 - Amendment 1</b>
<ul style="list-style-type: none"><li>• References the final BOR Recreation and Land Use agreement, including guidelines for the advanced reservation system.</li><li>• Delays the TPC's required contribution of 2.5% of golf course income into a Capital Improvement Fund (CIF) until 1990.</li></ul>
<b>Aug 1987 - Amendment 2</b>
<ul style="list-style-type: none"><li>• Reduces lease payment on golf course income from 10% to 7.5% for calendar years 1987 through 1991.</li><li>• Removes the TPC's 2.5% CIF contribution. The TPC will make repairs and improvements at its sole expense as it deems necessary.</li><li>• Uses the City's one-time \$100,000 contribution to the CIF for "bring-in" expenses, which were not defined.</li><li>• Waives the lease payments on Desert Course income until construction is completed.</li></ul>
<b>Jun 1988 - Amendment 3</b>
<ul style="list-style-type: none"><li>• Shifts the City's responsibility for \$515,000 in construction to the TPC with the costs to be deducted from the City's lease payments.</li><li>• TPC will pay about \$400,000 for revegetation of the golf courses, completion of cart paths, and certain improvements to the Desert Course, totaling about \$400,000.</li></ul>
<b>Jul 1994 - City Ordinance</b>
<ul style="list-style-type: none"><li>• City Council adopted Ordinance 2632, authorizing a surcharge of \$1 per 9-holes of golf played on all City-owned golf courses.</li><li>• In 1988 the BOR approved this surcharge being applied to the TPC courses. The Land Use Agreement addendum requires the City to maintain the fees in a separate fund and spent only to develop, operate, maintain, or improve the TPC golf facility and lands. Expenditures must be approved by the BOR.</li></ul>
<b>Dec 1995 - Amendment 4</b>
<ul style="list-style-type: none"><li>• PGA TOUR will continue holding an annual TOUR Event at the TPC for another 10 years, through 2006.</li><li>• Establishes procedures for approval of TPC rate adjustments.</li><li>• The City will provide free public parking for the Phoenix Open in the northeast corner of Bell Rd. and Hayden, and the TPC agrees to pay \$80,000 each year for 10 years for this additional parking.</li><li>• The City will purchase additional land adjacent to the golf course for parking and staging of the Phoenix Open. In exchange, TPC will contribute \$250,000 paid in \$80,000 increments annually.</li><li>• An additional \$27,371 will be added to golf course income beginning in 1996 when calculating rent payments. This amount shall be increased by 4% each year for the life of this Agreement and any extensions.</li></ul>
<b>Jul 1999 - Amendment 5</b>
<ul style="list-style-type: none"><li>• Provides more details about the parking area stipulated by Amendment 4 and makes minor modifications to each party's rights and responsibilities.</li></ul>
<b>Dec 2012 - Amendment 6</b>
<ul style="list-style-type: none"><li>• The City will fund \$15 million for Stadium Course and clubhouse improvements.</li><li>• PGA TOUR will continue holding an annual TOUR Event through 2022, subject to a Sponsor Failure Payment in certain circumstances.</li><li>• PGA TOUR will guarantee national television coverage of the tournament through 2021.</li><li>• TPC will pay an additional rent of 2.5% on golf course income to the City.</li></ul>

Source: Auditor analysis of the TPC Lease and Management Agreement, and subsequent amendments 1-6.

Moreover, the TPC’s quarterly lease payment for January through March 2013 was almost \$400,000, the highest quarterly payment since the same period in 2008. Revenue generated during this time of year primarily reflects the Phoenix Open held in February and the peak tourism period. Figure 3 depicting the average quarterly lease payments over the last 5 full fiscal years reflects the seasonal change in golf course revenues. Activity in the second half of the fiscal year (January through June) typically generates 65% of the annual lease payments.

**Figure 3. TPC Scottsdale Lease Payments, 5-Year Quarterly Average**



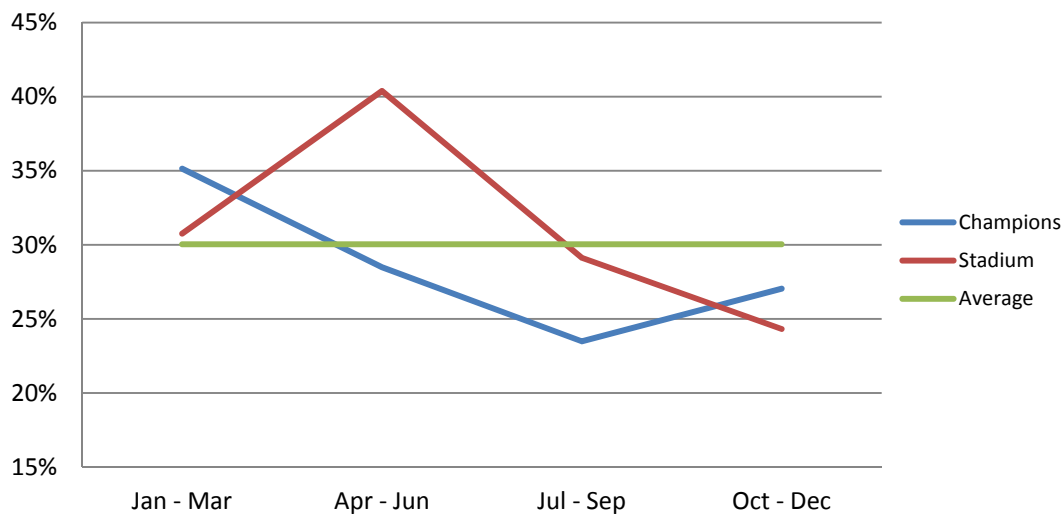
SOURCE: Auditor analysis of SmartStream financial reports.

Analysis of rounds played and golf course utilization percentages confirm a similar trend. While on average, 30% of available starting times were booked for play in 2011 and 2012, the percentage is higher during the first half of the calendar year and lower during the second half of the year. As depicted in Figure 4 on page 7, the Stadium Course sees more seasonal variation than the Champions Course does.

Besides seasonal changes, course utilization also varies depending on the time of day, with higher demand in the morning, and day of the week, with weekends proving most popular. Additionally, daytime temperatures in the Valley are in the triple digits during the summer months; the TPC accommodates with starting times as early as 6:26 am. Regular course hours are around 7:00 am to 7:00 pm. Utilization rates are also affected by the start intervals used to calculate available tee times; TPC bases its availability on 8-minute intervals between golfers.<sup>4</sup>

<sup>4</sup> In contrast, another tournament-level municipal golf course is open from 8 am to 6 pm 7 days a week. Therefore, this course would have fewer available start times and a higher utilization rate given the same number of rounds played.

Figure 4. Average Course Utilization, CY 2011-2012<sup>a</sup>



<sup>a</sup> Excludes tee times during Stadium Course closure for greens repairs in July - August 2011 and July 2012.

SOURCE: Auditor analysis of TPC Scottsdale course utilization reports.

### *Golf Surcharges*

Pursuant to the BOR Recreation Land Use Agreement and City Ordinance 2632, the TPC Scottsdale also collects and remits to the City a round surcharge of \$1 per 9-holes played. These monies are held in the Basin Management Reserve Fund (BMF) and, with prior approval of the BOR, can be used by the City to develop, operate, maintain, or improve the TPC Scottsdale golf facility and lands.

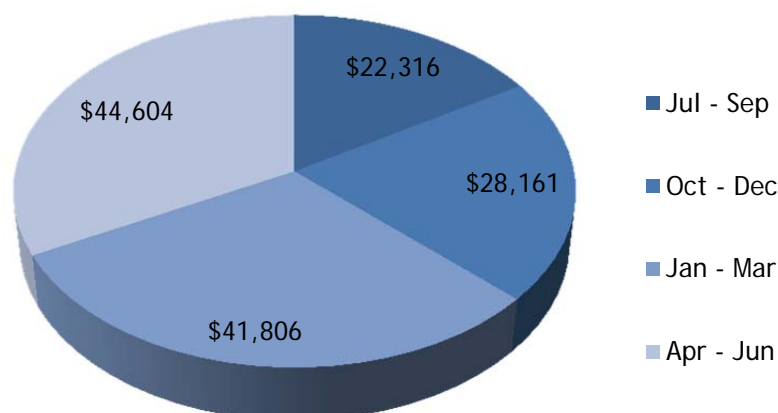
Shown in Figure 5, BMF surcharge payments from the TPC Scottsdale averaged \$136,887 for the 5-year period of FYs 2007/08 through 2011/12. Almost \$100,000 has been paid during FY 2012/13 through March 2013.

In addition to the BMF surcharge, the BOR approved the TPC Scottsdale to add a \$5 surcharge per 18-holes played to recover costs for a fairways remediation project. This surcharge is not remitted to the City, but retained by the TPC Scottsdale to help recover its costs of addressing high levels of salt deposits from the irrigation water. In 2008, the City paid \$3 million towards this soil remediation, but when it was determined to be an ongoing cost, the BOR approved the \$5 surcharge. To date, the project costs have totaled approximately \$5.9 million, including the portion funded by the City. After recovering costs of other BOR approved projects, TPC Scottsdale has applied \$361,000 of surcharge proceeds to the Fairway Remediation Project as of April 2013.



Figure 5. TPC Payments of the BMF Ticket Surcharge, 5-Year Average by Quarter

Fiscal Year	Total
2007/08	\$125,671
2008/09	129,280
2009/10	139,637
2010/11	145,476
2011/12	144,374
5-Yr. Avg.	\$136,887



FY 2012/13 \$ 99,758  
through March 2013

SOURCE: Auditor analysis of SmartStream financial reports.

## OTHER AGREEMENT TERMS

### *Golf Course Rates*

The 1996 BOR fee policy requires the TPC golf course fees to be charged on a consistent and equal basis, with no special rates other than for general classes such as seniors, youth and armed forces personnel.<sup>5</sup> Further, rate increases of more than 5% per year or any discounts, specific class rates, or specific group or user rates must be approved by the BOR. The Lease Agreement also states that TPC golf course rates are subject to a review by a committee of the City Council at a public hearing, and the City Manager is required to advise the BOR of the action taken.

In a November 2001 memo to the City, the BOR stated it considered the approved rate to be a maximum fee. The BOR supported the TPC Scottsdale having flexibility to market the golf course facilities to be competitive among courses offering similar accommodations. Currently, the TPC Scottsdale uses a variety of marketing methods, such as golf packages sold to wholesalers at a discount, resident rates at the Champions Course, and discounted prices for guests of members and staff. Additionally, the TPC monitors its sales trends and may offer other discount prices to increase volume.

### *Reservation System*

Reservations can be made 90 days in advance for the Stadium Course and 7 days in advance for the Champions Course. The Lease Agreement includes a policy intended to ensure fair access to the general public, which requires that, on an annual basis, at least 80% of available starting reservations must be available to the general public leaving up to 20% of available

<sup>5</sup> Discretionary fees (optional fees) only require the approval of the City of Scottsdale.

starting reservations that can be made on a priority basis.<sup>6</sup> This policy and any changes to it require approval by the BOR as set out by Agreement section 6.3.3.

#### LEASE AGREEMENT OVERSIGHT

As required by the City's Administrative Regulation 215, *Contract Administration*, the contract administration duties have been assigned for the TPC Lease Agreement. As of December 2012, these responsibilities are shared between two contract administrators: a Real Estate Management Specialist in the Public Works Division performs the overall administration, including monitoring the financial and insurance aspects of the Agreement, while a Parks & Recreation Manager of the Community Services Division continues to provide direct oversight of golf operations and serve as a liaison with TPC and BOR staff. In prior years, the Parks & Recreation Manager performed all contract administration duties.

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<sup>6</sup> Priority reservations are those outside of what is normally available to the general public.





## OBJECTIVES, SCOPE, AND METHODOLOGY

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An audit of a selected City lease agreement was included on the City Council-approved Fiscal Year (FY) 2012/13 Audit Plan. Six major leases were evaluated based on factors including dollar value and complexity of the lease payments, such as rent based on a percentage of sales rather than a fixed fee rent. We selected the Tournament Players Club (TPC) Lease and Management Agreement (Lease Agreement) for this audit.

To gain an understanding of regulatory laws and regulations related to the Lease Agreement, we reviewed:

- Contract 850060, with amendments 1 through 6, *TPC Lease and Management Agreement*, between the Tournament Players Club of Scottsdale, Inc., PGA TOUR, Inc., and the City.
- Contract 860299 with amendments 1 through 9, *Bureau of Reclamation (BOR) Recreational Land Use Agreement*, between the United States of America and the City.
- City Ordinance 2632, *Establishing a Surcharge on the Usage of City Golf Courses*.
- Administrative Regulation 215, *Contract Administration*.

To verify oversight responsibilities and identify internal controls over terms of the Lease Agreement, we interviewed the Contract Administrators, including a Parks & Recreation Manager of the Community Services Division and a Real Estate Management Specialist of the Public Works Division. We also interviewed TPC Scottsdale personnel, including the Accounting Director, Senior Business Development Director, and Head Golf Professional related to financial records and golf operations. Additionally, we interviewed the Chief Accountant of the Fairmont Scottsdale Princess, which operates The Grille at TPC and provides food and beverage services during the Phoenix Open.

To validate the completeness and accuracy of TPC revenues and rounds of golf played, which are key factors in the calculation of lease and ticket surcharge payments, we:

- Interviewed the TPC Accounting Director to gain an understanding of the TPC's internal controls over cash handling and revenue reporting.
- Compared the TPC's general ledger revenues to point-of-sale reconciliations and deposit records for randomly selected days in FYs 2011/12 and 2012/13.
- Analyzed the TPC Scottsdale's general ledger year-to-date revenues to quarterly payments and revenue reports sent to the City.
- Reviewed revenues reported to the TPC Scottsdale by the Fairmont Scottsdale Princess for The Grille operations and Phoenix Open food and beverage sales. To validate the completeness of these reported revenues, we:
  - Interviewed the Chief Accountant of the Fairmont Scottsdale Princess to gain an understanding of internal controls over cash handling and revenue reporting.
  - Reviewed detailed Property Management System reports and general ledger reports for a selected time frame during FY 2011/12.
  - Reviewed the company's annual profit and loss statements for The Grille and Phoenix Open concessions.

- Analyzed the TPC's records of "rounds played" for calendar years 2011 and 2012 and compared to those reported to the City.
- Analyzed the TPC's records of complimentary golf played for calendar years 2011 and 2012.

To determine the TPC Scottsdale's compliance with contract requirements for rate setting and fee adjustments as outlined in section 6.2.2 of the Lease Agreement, we reviewed the BOR's *Reclamation Rate Approval and Adjustment Policy for the Scottsdale Golf Complex* and compared this against the current process for setting and increasing golf rates.<sup>7</sup>

Additionally, to determine the TPC Scottsdale's compliance with the BOR-approved reservation policy as set out by section 6.3.3 of the Lease Agreement, we reviewed the *Tournament Players Club at Scottsdale Reservation Policy*, interviewed TPC management about the reservation system and procedures, and reviewed advance booking reports for 2011 and 2012.<sup>8</sup>

As a result of these procedures, our audit found that the TPC Scottsdale's reported revenues and rounds were relatively accurate, but we identified potential unreported revenue due to complimentary golf rounds provided to employees or for promotional/marketing purposes. Additionally, an amount required by a 1995 amendment to the Agreement to be added to the rent calculation has not been included. As well, contract administration can be improved to ensure compliance with all contract terms.

We conducted this audit in accordance with generally accepted government auditing standards as required by Article III, Scottsdale Revised Code, §2-117 et seq. 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. Audit work took place from March through May 2013.

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<sup>7</sup> The *Rate Approval and Adjustment Policy* is referenced in the TPC Lease Agreement's 4<sup>th</sup> Amendment in 1995. The BOR last revised this policy in December 1996, but issued a memo regarding marketing flexibility in 2001.

<sup>8</sup> The BOR-approved reservation policy was included as an attachment to the TPC Lease Agreement's 1<sup>st</sup> Amendment in 1984. The policy was last revised in June 1998.

## FINDINGS AND ANALYSIS

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1. Revenues reported to the City are generally accurate, but additional income required by contract is not included and complimentary golf rounds need to be considered.

- A. The revenues that are reported are generally accurate, with minor discrepancies related to timing and year-end adjustments.

The TPC Scottsdale accounting department compiles a detailed quarterly revenue report that is submitted to the Contract Administrator along with its quarterly rent payment. Auditor testing of the calendar years 2011, 2012, and first quarter 2013 rent reports found that generally the rent reports accurately reflected the company's operating revenues, with a few minor exceptions:

- **Timing of purchase rebates** - Cash-back rebates from the use of purchasing cards and other similar programs through vendors are received by the TPC's corporate office and allocated to its various golf clubs. The TPC typically makes its fourth quarter rent payment when due in late January, but may not finalize its calendar year accounting until the end of January. As a result of these rebates, the 2011 and 2012 rent payments were underpaid by \$2,228.
- **Minor errors in rent calculation** - The discount for gift card promotions and the expense from a charity donation was incorrectly deducted from revenues in the rent calculation in 2012. The resulting rent underpayment was \$396.
- **Incorrect calculation related to the Fairmont Scottsdale Princess food and beverage operations** - The Fairmont Scottsdale Princess (Princess) operates The Grille at TPC restaurant and provides food and beverage service during the Phoenix Open. The TPC Scottsdale's agreement with the Princess requires the Princess to pay 2% of its gross revenues for these operations, with the exception of a specific venue during the Open for which the rate is 5%.

The TPC Scottsdale deducts the net Princess payment from its golf course revenues and reports these Princess revenues at gross along with its other food and beverage sales, and then calculates the rent owed to the City. For the first quarter 2013 payment, the TPC Scottsdale deducted the wrong amount from its golf course revenues and underpaid the City \$1,033.

For the period reviewed by auditors, these underpayments in rent totaled \$3,657. Review of annualized revenue reports after the year-end adjustments may help identify potential future errors related to timing or other calculation mistakes.

Because its financial information is combined into the consolidated financial statements of its parent company, PGA TOUR, Inc., the TPC Scottsdale does not provide the Contract Administrator with audited annual financial statements as required by the Lease Agreement. However, the Contract Administrator has not requested to see other accounting reports to ensure reliability of the reported results.

- B. An additional rent stipulated by the 4<sup>th</sup> amendment to the Lease Agreement has not been paid. Amendment 4 modifies section 1.1.16 of the Lease Agreement to state:

*“Beginning in 1996, an additional amount of \$27,371 shall be added to Golf Course Income. The additional \$27,371 shall be increased annually thereafter, for the life of this Agreement or extension hereof, at a per annum rate of four percent (4%).”*

However, these amounts have not been included in the rent payments. The TPC Scottsdale Accounting Director and the Contract Administrator were not aware of the requirement. Subsequently, the current TPC Scottsdale General Manager indicated that this amount may have been added to repay the City for a land purchase, but instead the City was repaid directly. At the time of our audit, no records were available to substantiate the reason for not including the amount.

Cumulatively from 1996 through 2012, including the 4% annual increases, the unpaid rent to the City would total \$64,862. Including the 4% annual increases, the added rent for 2013 would equal \$5,332.

- C. The value of unreported complimentary rounds may significantly impact rent and Basin Management (BMF) surcharges and needs to be further reviewed by the City.

Although the Lease Agreement does not provide an allowance for complimentary golf, the value of complimentary golf has not been included in the rent calculation. Further, these discounts or special pricing have not been submitted for City or BOR rate approval. Most complimentary rounds were given as a benefit to TPC employees (about 38% of the total) or for promotional and marketing purposes. As such, these should be provided at the TPC’s expense, rather than reducing revenue to the City.

- The value of complimentary rounds over the period of 2011 through the first quarter of 2013 totaled nearly \$2.1 million when estimated using average course pricing. As shown in Table 1, the rent and BMF fees associated with these complimentary rounds would together total more than \$239,000. Approximately 7% to 8% of the TPC’s total rounds played during this time period were complimentary rounds.
- The TPC Scottsdale’s corporate office occasionally gives complimentary memberships for use of the golf course. In 2011, \$20,000 in memberships were given out and included in the rent calculation. The 2011 payment was included in the rent calculation due to the timing of the rent reporting, but generally, it would not be included because these complimentary memberships are typically reported as a reduction in expense, rather than as revenue.

**Table 1. Calendar Year 2011, 2012, and 1st Quarter 2013 Lease Agreement Underpayments**

	CY 2011	CY 2012	1st Qtr 2013	Total
Understated Revenues	\$ 1,239	\$ 1,385	\$ 1,033	\$ 3,657
Additional Income per Amend 4 <sup>a</sup>	\$ 4,929	\$ 5,127	\$ 1,333	\$ 11,389
Complimentary Rounds - Rent	\$ 78,461	\$ 93,877	\$ 36,921	\$ 209,259
Complimentary Rounds - BMF Surcharges	\$ 12,196	\$ 14,206	\$ 3,640	\$ 30,042

<sup>a</sup> For years 1996-2010, cumulative rent that would be owed for the additional golf course income amount stipulated in Amendment 4 totals to \$54,807. For 1<sup>st</sup> Qtr 2013, the full year's rent would total \$5,332.

SOURCE: Auditor analysis of TPC Scottsdale general ledger reports, rounds played reports, and contract terms.

Additionally, the Fairmont Scottsdale Princess provides complimentary meals to its employees and for promotional purposes at its Stadium clubhouse restaurant. These are also not included in the revenue reports to the City. Although the complimentary meals are specifically addressed in the contract between the two parties, it is not specified in the City's TPC Lease Agreement.

While the Lease Agreement does not specifically prohibit them, complimentary golf and meals are business expenses that the TPC chooses to incur. These costs would be more appropriately recorded in TPC's accounting records as an expense rather than reducing revenues on which the City's rent is based. Further, if the City approves of this practice, BOR approval would be needed for the special rate class.

**Recommendations:**

The Community Services and Public Works Executive Directors should ensure the Contract Administrators:

- A. Compare rent reports to a general ledger revenue report and reservation system rounds reports generated after the company's year-end closing of its books, to ensure completeness of revenues reported.
- B. Unless substantiating documentation can be located that confirms the City has already been repaid, ensure the added amount required by the Lease Agreement is included in the rent calculation, either in quarterly amounts or at a specified time of year.
- C. Work with the City Attorney's office to determine whether complimentary rounds and meals should be included in the rent calculation and the complimentary rounds in calculating BMF surcharges. In addition, if the City approves of the current practice, obtain BOR approval.

2. **Contract administration can be improved to ensure all Lease and BOR Agreement terms are met.**

Compliance with certain agreement terms related to golf rates and advanced reservations can be improved with strengthened oversight by Contract Administrators. Using the City's Finance & Accounting Division to establish receivables accounts for lease and BMF surcharge payments and Remittance Processing functions to process these payments can improve internal controls.

A. **The Contract Administrator has not submitted TPC golf rate increases for approval as required.**

Lease Agreement terms, as updated by Amendment 4, require that at a public meeting a committee of the City Council is to review TPC fee increases for compliance with established fee adjustment procedures, and, if approved, the BOR is to be notified of the action. Further, if the increases are greater than 5% per year, BOR's approval is also required; however, the TPC rate changes have not needed this approval.

- **Rate increases not submitted for Council approval** – Over time it appears that the review and approval of golf course fees has diminished to simply receiving an annual notification from the TPC that its maximum rates will be increased by 5%. The Contract Administrator has not submitted the rate increases for Council approval, believing that TPC rate increases of 5% or less did not require approval from the BOR or the City. Additionally, due to a change in general managers, the TPC did not notify the Contract Administrator when the TPC increased its rates for calendar year 2013.

Further, while its approval is not required for annual rate increases of 5% or less, the BOR policy still requires notification 15 days prior to the new rates being effective and BOR has the authority to reject the increase within that time frame.

- **Complete fee schedule not reviewed** – The 2012 rate increase detail provided to the Contract Administrator only listed the maximum rate for an 18-hole round at each course. In contrast, the golf course's posted rates include seasonal and other variations for each course, such as: 1) resident and non-resident rates, 2) non-peak season rates, and 3) other special rate tiers, including junior golfers, twilight rates, replay rates, and day-of-play rates. To comply with terms of the lease amendment, complete rate schedules should be submitted to ensure the City Council has had an opportunity to review and approve all rate variations.

B. **Compliance with the Reservation System Policy not monitored.**

The Lease Agreement establishes a BOR-approved policy for advanced and priority reservations of tee times aimed at maintaining the general public's accessibility to the golf course. The policy restricts priority reservations to 20% of all available tee times, on an annual basis and outlines daily and hourly limits. TPC management defines "priority" reservations as those booked outside of the regular reservation period available to the general public, which is up to 90 days in advance for the Stadium Course and 7 days in advance for the Champions Course. According to TPC management, requests for reservations outside of this period are considered on a case-by-case basis. The only other tee times reserved on a priority basis is for a group that pays annual fees to reserve a block of 24 to 30 tee times every Saturday morning. As

shown in the Table 2, the percentage of tee times reserved on a priority basis is well below the 20% annual limit.

**Table 2. Percentage of Available Start Times Made on a Priority Basis**

	<u>2011</u>	<u>2012</u>
<b>Champions Course</b>		
Priority Reservation	8%	8%
General Reservations	22%	22%
<b>Stadium Course <sup>a</sup></b>		
Priority Reservation	4%	4%
General Reservations	28%	30%
<b>Annual Average Priority</b>	<b>6%</b>	<b>6%</b>
<b>Total Annual Start Times</b>	<b>270,000</b>	<b>282,000</b>

<sup>a</sup> Analysis excludes Stadium Course closures during the Phoenix Open and other course closures for maintenance and reseeded.

SOURCE: Auditor analysis of TPC Scottsdale course utilization and advanced booking reports.

In addition to the annual limits, the reservation policy also sets daily limits for priority reservations at 30% of available times, not to exceed 6 per hour. However, because of its low annual rate, the TPC does not monitor the daily limits for priority reservations. The daily advanced booking report for January through April 2012 showed the Champions Course may have exceeded the 30% limit at least 14 times.<sup>9</sup> Generally, priority reservations are highest during peak visitor times in February and on weekends.

The City's Contract Administrator had not been monitoring compliance with the priority reservation limits in some time. Regular monitoring would help ensure compliance or identify that part of the policy may need to be reconsidered by the City, TPC and the BOR.

- C. Currently, there is an increased risk of loss because a receivable account has not been established for the TPC lease and BMF fee payments, and the payments are not remitted directly to the City's Remittance Processing Center.

The TPC payments are recorded as revenues when received rather than recording an estimated amount in the period earned. A receivable record also serves as a reminder to collect the amount owed. In addition, the Contract Administrator picks-up the TPC's quarterly payments directly and, after reviewing the supporting report, hand-

<sup>9</sup> Analysis based on the 356 estimated tee times typical for April and May. There can be fewer actual tee times in winter and early spring, which would result in priority reservations being a higher percentage.

delivers the payment to the Finance & Accounting Division office. This process is not an efficient use of the Contract Administrator's time and increases the risk of loss or theft of the check. As well, the Contract Administrator retains a copy of the TPC checks in his file, but had not redacted sensitive information.

- D. Projects partially funded by City monies or BOR-approved surcharges not tracked by Contract Administrator.

According to TPC Scottsdale management, the golf course was approved by BOR in 2000 to charge an additional \$2 surcharge on each 18-hole round to recover costs for various capital projects completed by the TPC, including the Desert Course Greens Project, the Bridge Project, Cart Path Project, and the Fairway Remediation Project. This surcharge is retained by the TPC and is in addition to the BMF surcharge remitted to the City. The surcharge was later increased to \$5 in 2010.

According to TPC Scottsdale management reports, the total surcharges collected over the 13 years and applied to various projects is about \$2.37 million. The only current project, the Fairway Remediation Project, has cost approximately \$5.9 million to date, including \$3 million paid by the City in 2008. The TPC Scottsdale started applying the surcharge monies to this project in 2012 after costs from past projects had been recovered. As of April 2013, the total amount of surcharges applied to this project is about \$361,000.

Despite the fact that some of these projects were partially funded by the City and BOR-approved surcharges, the Contract Administrators over these years have not retained documentation regarding the specific terms of the various projects. They also have not required the TPC Scottsdale to report on the costs of the various projects or the amounts collected through the additional surcharge. While these projects are not City capital projects, as with the City's BMF monies, specific accounting for the additional TPC surcharge is important to maintain accountability for the surcharge monies.

#### Recommendations:

The Community Services and Public Works Executive Directors should ensure the Contract Administrators:

- A. Improve compliance with the BOR-approved fee adjustment policy, including requiring that complete fee schedules accompany the TPC's rate increase requests.
- B. Monitor compliance with the BOR-approved reservation policy. If it appears modifications may be needed, the Contract Administrator should ensure any requested changes are subject to approval by the City Council and the BOR to ensure the modifications still meet the goals of course accessibility to the general public.
- C. Also, the Contract Administrators should work with the City's Finance & Accounting Division staff to establish a receivables account for the TPC lease and BMF ticket surcharge payments and work with the TPC to direct payments through the City's Remittance Processing Center.
- D. Require the TPC Scottsdale to report on amounts collected and the specific projects funded through the \$5 surcharges to ensure the monies are used only for approved purposes.



## MANAGEMENT ACTION PLAN

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1. Revenues reported to the City are generally accurate, but additional income required by contract is not included and complimentary golf rounds need to be considered.

### Recommendations:

The Community Services and Public Works Executive Directors should ensure the Contract Administrators:

- A. Compare rent reports to a general ledger revenue report and reservation system rounds reports generated after the company's year-end closing of its books, to ensure completeness of revenues reported.

MANAGEMENT RESPONSE: Agree

PROPOSED RESOLUTION: The Contract Administrator will implement a system of reconciliation of reported revenue immediately and will complete an annual review by April 30th of each year.

RESPONSIBLE PARTY: Real Estate Management Specialist

COMPLETED BY: Annually by April 30<sup>th</sup>

- B. Unless substantiating documentation can be located that confirms the City has already been repaid, ensure the added amount required by the Lease Agreement is included in the rent calculation, either in quarterly amounts or at a specified time of year.

MANAGEMENT RESPONSE: Agree

PROPOSED RESOLUTION: Notification will be prepared to TPC General Manager that the 4th Quarter revenues must include the additional revenue required by Section 1.1.16 of amendment 4 to the lease (now Section 1.1.20) unless substantiating documentation can be located that confirms the city has already been repaid.

RESPONSIBLE PARTY: Real Estate Management Specialist

COMPLETED BY: September 30, 2013

- C. Work with the City Attorney's office to determine whether complimentary rounds and meals should be included in the rent calculation and the complimentary rounds in calculating BMF surcharges. In addition, if the City approves of the current practice, obtain BOR approval.

MANAGEMENT RESPONSE: Agree

PROPOSED RESOLUTION: (1) meet with City Attorney's office concerning complimentary rounds and meals; and (2) review procedures with BOR.

RESPONSIBLE PARTY: Real Estate Management Specialist & Parks and Recreation Manager

COMPLETED BY: September 30, 2013

2. Contract administration can be improved to ensure all Lease and BOR Agreement terms are met.

**Recommendations:**

The Community Services and Public Works Executive Directors should ensure the Contract Administrators:

- A. Improve compliance with the BOR-approved fee adjustment policy, including requiring that complete fee schedules accompany the TPC's rate increase requests.

MANAGEMENT RESPONSE: Agree

PROPOSED RESOLUTION: (1) require that TPC provides complete fee schedules to support TPC's rate increase request; (2) City Manager will review methodology to seek City Council approval of compliance with fee adjustment procedures.

RESPONSIBLE PARTY: Parks and Recreation Manager

COMPLETED BY: December 1<sup>st</sup> for any annual TPC rate increase request

- B. Monitor compliance with the BOR-approved reservation policy. If it appears modifications may be needed, the Contract Administrator should ensure any requested changes are subject to approval by the City Council and the BOR to ensure the modifications still meet the goals of course accessibility to the general public.

MANAGEMENT RESPONSE: Agree

PROPOSED RESOLUTION: Regular monitoring on a quarterly schedule to ensure compliance with the approved policy will be implemented. Prepare policy modifications as needed for City, TPC, and BOR approval if required by monitoring program.

RESPONSIBLE PARTY: Parks and Recreation Manager

COMPLETED BY: 30 days after each quarterly report comes due

- C. Also, the Contract Administrators should work with the City's Finance & Accounting Division staff to establish a receivables account for the TPC lease and BMF ticket surcharge payments and work with the TPC to direct payments through the City's Remittance Processing Center.

MANAGEMENT RESPONSE: Agree

PROPOSED RESOLUTION: Contract Administrator will work with Financial and Accounting staff to establish a receivables account and develop an invoicing form for TPC quarterly payments. 2nd Quarter payments will follow revised procedure.

RESPONSIBLE PARTY: Real Estate Management Specialist

COMPLETED BY: June 28<sup>th</sup>

- D. Require the TPC Scottsdale to report on amounts collected and the specific projects

funded through the \$5 surcharges to ensure the monies are used only for approved purposes.

MANAGEMENT RESPONSE: Agree

PROPOSED RESOLUTION: (1) Meet with TPC Senior General Manager and TPC Accountant to compile project list and expenditure for each project; (2) reconcile \$5 surcharge monies collected with completed projects for approved purposes; and (3) build spreadsheet template for TPC reporting that TPC will add to future quarterly reporting under Item 2.C above.

RESPONSIBLE PARTY: Parks and Recreation Manager

COMPLETED BY: August 1, 2013

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