



CITY AUDITOR'S OFFICE

Destination Marketing Contract

November 11, 2016

AUDIT REPORT NO. 1705

[January 12, 2017: On page 13, clarified Town of Paradise Valley contribution for Fiesta Bowl contract.]

CITY COUNCIL

Mayor W.J. "Jim" Lane
Suzanne Klapp
Virginia Korte
Vice Mayor Kathy Littlefield
Linda Milhaven
Guy Phillips
David N. Smith



November 11, 2016

Honorable Mayor and Members of the City Council:

Enclosed is the audit report for *Destination Marketing Contract*, which was included on the Council-approved FY 2016/17 Audit Plan. This audit evaluated compliance with terms and effectiveness of controls in the City's destination marketing contract with Experience Scottsdale.

The City is currently in the last year of a 5-year contract with Experience Scottsdale for destination marketing services. The City pays half of its Bed Tax revenue for this contract, which totaled \$9.4 million in FY 2015/16. Our audit found that performance measure goals and results could be more relevant by separating city activity from total activity, and financial oversight of the contract and contract administration can be improved.

We appreciate the cooperation and assistance of the Tourism and Events department as well as Experience Scottsdale during the course of this audit. If you need additional information or have any questions, please contact me at (480) 312-7867.

Sincerely,

Sharron E. Walker, CPA, CFE, CLEA
City Auditor

Audit Team:

Kyla Anderson, CIA, CLEA - Senior Auditor
Brad Hubert - Internal Auditor

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AUDIT HIGHLIGHTS

Destination Marketing Contract

November 11, 2016

Audit Report No. 1705

WHY WE DID THIS AUDIT

An audit of the Destination Marketing contract was included on the City Council-approved FY 2016/17 Audit Plan.

The audit objective was to evaluate compliance with terms and effectiveness of controls in the City's destination marketing contract.

BACKGROUND

Since 2001, the City has contracted with the Scottsdale Convention & Visitor's Bureau (now Experience Scottsdale) for destination marketing services. The current 5-year contract with Experience Scottsdale is set to expire at the end of this fiscal year.

In addition to destination marketing services, the contract incorporates funding for Experience Scottsdale's Fiesta Bowl contract.

The City pays for the contracted services using 50% of the collected Bed Tax funds. In FY 2015/16, the contract cost about \$9.4 million.

More than 90% of Experience Scottsdale's funding comes from tax dollars, with sources including Scottsdale, the Town of Paradise Valley and State of Arizona. The remaining 10% comes from private sources like member dues and advertising. Scottsdale contributions have increased by 34% during the contract period, while the other funding sources have remained relatively flat.

City Auditor's Office

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WHAT WE FOUND

Performance measure goals and results could be more relevant.

Experience Scottsdale is required to annually prepare performance criteria. Review of the performance measures found that:

- Performance goals are set as guaranteed minimums rather than establishing performance expectations. Some measures are not reporting on Scottsdale benefit, and a few data errors were made.
- Scottsdale hotels and other tourism-related businesses are not prioritized.

Financial oversight of the destination marketing contract can be improved.

Specifically, we found:

- The reported private reserves are likely partially funded with City revenue and some reported marketing is funded with State tax dollars.
- The City pays the full cost of Experience Scottsdale's Fiesta Bowl contract.
- The contract does not specify allowable uses of Bed Tax funds.
- The City's McCormick-Stillman Railroad Park was charged for advertising.

Contract administration can be improved.

The Contract Administrator is responsible for monitoring contract compliance. We found the following:

- Performance measure documentation has not been required.
- Experience Scottsdale's purchasing process was not reviewed and approved.

WHAT WE RECOMMEND

We recommend the Tourism & Events department consider:

- Requiring performance goals be based on prior actual results or known modifications.
- Adding contract requirements to separately report Scottsdale-related performance and prioritize Scottsdale businesses in its activities.
- Requiring Scottsdale expenses be tracked separately or all expenses prorated based on funding proportion and establishing terms related to a reserve.
- Requiring shared Bed Tax revenues pay for the cost of the Fiesta Bowl agreement or that Scottsdale only contributes a proportionate share of the costs, including the value of the in-kind police services.
- Providing guidelines for allowable uses of Bed Tax funding and requiring City advertisements be included in Experience Scottsdale's publications at no additional cost.

As well, the department should ensure terms in the new destination marketing contract are appropriate and enforced, such as reviewing the marketing materials and procurement process.

MANAGEMENT RESPONSE

The Department agreed with the findings and will consider the recommendations for the next destination marketing contract for FY 2017/18.

BACKGROUND

Since 2001, the City of Scottsdale has contracted with the Scottsdale Convention & Visitors Bureau (now Experience Scottsdale) for destination marketing services.¹ Experience Scottsdale, a 501(c)(6) non-profit destination marketing organization, also promotes the Town of Paradise Valley, two tribal governments and its member businesses.

The City's Tourism and Events Department manages the Experience Scottsdale contract. Currently, the Tourism and Events Director is the named contract administrator with day-to-day responsibility delegated to the Tourism Development Manager.

The City's 5% Transient Occupancy tax, typically referred to as Bed Tax, funds this destination marketing contract. Such a public-private partnership arrangement between municipalities and Destination Marketing Organizations (DMO) is common industry-wide, and according to an industry survey, more than 75% of responding large DMO's receive hotel room tax funding from a city or other government.²

Destination Marketing Organization (DMO)

Entity that promotes a location in order to increase the number of visitors.

Experience Scottsdale

The City's DMO, previously known as Scottsdale Convention & Visitor's Bureau.

Destination Marketing Contract

Now in its last year, the City's current five-year contract with Experience Scottsdale expires June 30, 2017. Through this agreement, the City pays Experience Scottsdale 50% of the annual Bed Tax revenue, which has ranged from \$7.0 million to an expected \$9.7 million over the last 5 years. The agreement's seven marketing objectives are shown in Figure 1 on page 4.

The contract also specifically requires Experience Scottsdale to annually produce a Destination Marketing Guide, performance standards and a contract budget for City Council approval. The Destination Marketing Guide provides an industry outlook and the organization's annual strategic initiatives. For example, its FY 2016/17's strategic initiatives include launching a new brand and corporate identity and better deploying sales staff to enhance efforts. The performance standards establish the metrics for evaluating Experience Scottsdale's annual results, such as number of confirmed convention bookings and travel articles generated. Finally, the budget outlines all estimated sources of revenues and uses of funds for the coming year.

(continued on next page)

¹Prior to 2001, the City paid Bed Tax dollars to the Scottsdale Chamber of Commerce to promote tourism and convention business. The Scottsdale Convention & Visitor's Bureau rebranded as *Experience Scottsdale* in September 2016.

² 2015 DMO Organizational & Financial Profile Study by the Destination Marketing Association International.

Figure 1. Contract-Required Marketing Objectives



SOURCE: Contract 2012-053-COS

The City's destination marketing contract also incorporated, without specifying an amount, funding for Experience Scottsdale's separate Fiesta Bowl contract. In 2006, Experience Scottsdale and the Fiesta Bowl organization entered into a 20-year contract that requires both Fiesta Bowl teams to stay and practice in hotels that pay Scottsdale or Paradise Valley Bed Tax.³ The Fiesta Bowl also agreed to provide certain promotional benefits, including sponsor recognition for the City and Experience Scottsdale. In return, over the contract term, Experience Scottsdale will pay the Fiesta Bowl organization more than \$8 million and agreed to ensure the City of Scottsdale provides in-kind police services. In addition to paying 50% of Bed Tax revenues, the City has also paid \$200,000 to \$300,000 per year for Experience Scottsdale's annual financial commitment to the Fiesta Bowl organization.

Destination Marketing Program

To promote Scottsdale as a destination, Experience Scottsdale focuses on four major areas: marketing, communications, convention sales & services and tourism.

Marketing uses paid advertising, such as TV ads and social media outreach, to promote Scottsdale. In recent years, marketing efforts focused on Canada, Chicago, Los Angeles, New York City and San Francisco. Additionally, Experience Scottsdale staffs a Visitor's Center that is now located at Scottsdale Fashion Square.

³ The contract also required both National Championship teams to stay in the Scottsdale area when the game was in Arizona. However, due to the change in the college football championship, this provision is no longer applicable. In its first 4 years, the contract also required one Insight/Cactus Bowl team to stay and practice in Scottsdale or Paradise Valley.

Communications promotes “earned” media coverage. In addition to creating press releases and serving as a resource for journalists, Experience Scottsdale hosts familiarization tours for journalists and travel writers.

Convention Sales & Services works to bring business meetings and conventions to Scottsdale by promoting at trade shows, making sales calls and operating familiarization tours for U.S. and Canadian meeting planners.

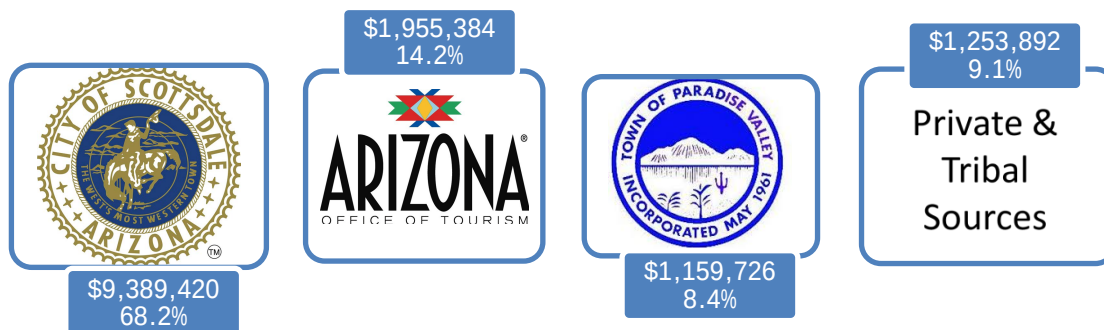
Tourism promotes Scottsdale to travel agents and tour operators who are primarily directed at leisure travel. Experience Scottsdale attends trade shows and conducts training seminars and familiarization tours focused on travel professionals in the United States, Canada, Mexico and Europe.

According to its Destination Marketing Guide, Experience Scottsdale’s target demographic is upscale leisure and business travelers.

Experience Scottsdale’s Funding Sources and Uses

More than 90% of Experience Scottsdale’s annual funding comes from tax dollars. As shown in Figure 2, Scottsdale contributed the most, more than \$9 million in FY 2015/16.

Figure 2. FY 2015/16 Experience Scottsdale’s Government Revenues



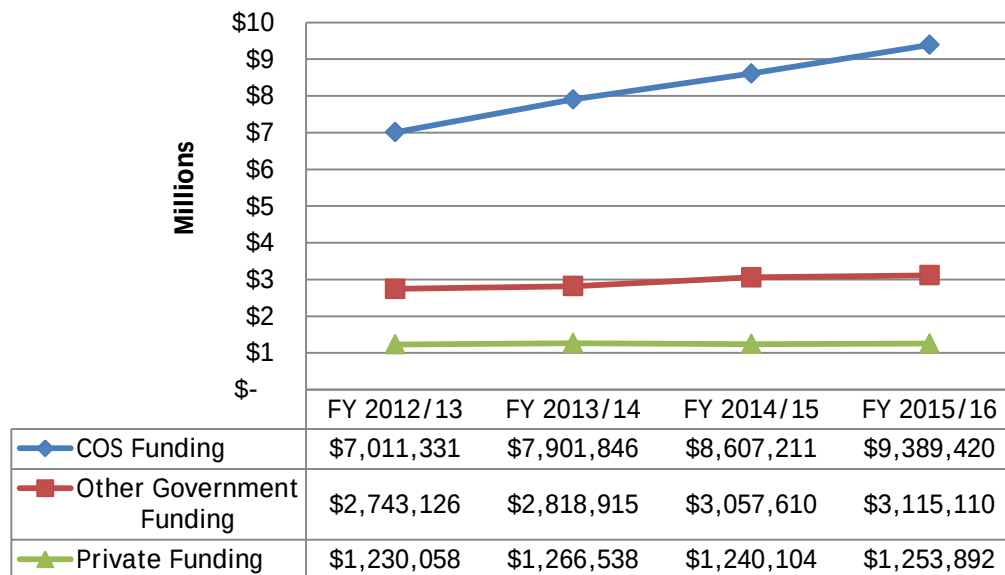
SOURCE: Auditor analysis of Experience Scottsdale financial statements

The organization’s private resources come from member dues and program fees. Experience Scottsdale’s approximately 400 members include hotels, restaurants and other service industry businesses in Scottsdale, Paradise Valley and neighboring communities as well as a few in more distant communities such as Sedona.

As shown in Figure 3 on page 6, City of Scottsdale payments have increased by \$2.4 million, or 34%, over the first 4 years of this contract as Bed Tax collections increased. The other government and private funding sources have remained relatively flat.

(continued on next page)

Figure 3. Experience Scottsdale's Revenue Sources



COS – City of Scottsdale

SOURCE: Auditor analysis of Experience Scottsdale financial statements

As shown in Table 1, Experience Scottsdale's total revenues increased almost \$3 million, or 25%, during the first 4 years of the contract period. Total expenses increased by 19% over the same period, with Marketing expenses increasing 27%. In contrast, Communications expenses decreased 6%.

Table 1. Experience Scottsdale's Revenue and Expenses

	FY 2012/13	FY 2013/14	FY 2014/15	FY 2015/16	Total % Change
Revenues	\$ 10,985,000	\$ 11,987,000	\$ 12,905,000	\$ 13,758,000	25%
Expenses					
Marketing	\$ 4,992,000	\$ 5,018,000	\$ 6,243,000	\$ 6,319,000	27%
Personnel	\$ 3,885,000	\$ 4,119,000	\$ 4,253,000	\$ 4,439,000	14%
Convention	\$ 608,000	\$ 667,000	\$ 688,000	\$ 701,000	15%
Communications	\$ 534,000	\$ 557,000	\$ 502,000	\$ 501,000	-6%
Tourism	\$ 303,000	\$ 303,000	\$ 275,000	\$ 316,000	4%
Other	\$ 795,000	\$ 869,000	\$ 852,000	\$ 975,000	23%
Total Expenses	\$ 11,117,000	\$ 11,533,000	\$ 12,813,000	\$ 13,251,000	19%
Net Income (Loss)	\$ (132,000)	\$ 454,000	\$ 92,000	\$ 507,000	

SOURCE: Auditor analysis of Experience Scottsdale 4th quarter detailed financial reports for FY2012/13 through FY 2015/16 provided to the City.

OBJECTIVES, SCOPE, AND METHODOLOGY

An audit of the *Destination Marketing Contract* was included on the City Council-approved fiscal year (FY) 2016/17 Audit Plan. The audit objective was to evaluate compliance with terms and effectiveness of controls in the City's destination marketing contract.

To understand the selected contract's requirements, we reviewed the following documents:

- Contract No. 2012-053-COS, Five Year Marketing Services Agreement between the City and Experience Scottsdale, and associated annual marketing guides, performance standards and contract budgets.
- Resolution No. 9242 dated November 13, 2012, adding P.F. Chang Rock & Roll Marathon & Half Marathon.
- Resolution No. 9587 dated December 10, 2013; Resolution No. 9907 dated October 7, 2014; Resolution No. 10252 dated November 10, 2015, adding the 2014, 2015 and 2016 Native Trails Events.

We also reviewed related Administrative Regulations (AR) including *AR 215 Contract Administration* and *AR 216 Contract Change Orders and Contract Modifications*. Additionally we reviewed the prior City Auditor report number 0909, *Scottsdale Convention & Visitors Bureau Agreement*, as well as similar audits conducted by other city auditors.

To gain an understanding of related legal requirements for uses of Bed Tax monies, we reviewed the following laws and policies:

- Relevant sections of Arizona Revised Statutes (ARS) Title 9 (Cities and Towns), particularly Chapter 4, Article 8, § 500.06 pertaining to *Hospitality Industry; use of tax proceeds*.
- Scottsdale Revised Code, Appendix C, Article IV, Privilege Taxes, § 447 – *Rental, leasing, and licensing for use of real property: additional tax upon transient lodging*.
- City Comprehensive Financial Policies & Governing Guidance, Policy 21 – *Use of transient lodging (bed) taxes*.

To obtain an understanding of program operations, including contract administration and compliance with contract terms we interviewed City Tourism & Events Department staff including the Tourism & Event's Director, Tourism Development Manager, and the Tourism Assistant, as well as the executive leadership team of Experience Scottsdale.

To determine if City Bed Tax funds are being expended reasonably and for the fulfillment of the destination marketing contract, we:

- Analyzed Experience Scottsdale's detailed general ledger data for FY 2015/16 and compared a sample of expenditures to the associated backup documentation.
- Reviewed Experience Scottsdale's Employee Handbook, which describes the established financial policies and controls.
- Reviewed the annual audited financial reports for FY 2010/11 – 2015/16 and IRS Form 990s for FY 2010/11 – 2014/15, as well as the quarterly and annual financial reports provided to the City's Contract Administrator.

To determine if reported performance metrics are relevant, accurate and supported, we reviewed the drivers and methodology used to calculate results. We also reviewed random

samples of backup documentation for each performance metric. Finally, we compared the list of hotels and other accommodations on the Experience Scottsdale website against City Bed Tax records to determine completeness and accuracy.

Our audit found the destination marketing contract can be improved in the areas of performance measures and financial controls. Further, contract compliance can be improved.

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 June to October 2016.

FINDINGS AND ANALYSIS

1. Performance measure goals and results could be more relevant.

Experience Scottsdale is required to annually prepare performance criteria before each contract year and provide a performance report afterward. The performance goals are being set as guaranteed minimums. Also, some performance measures, as reported, are not relevant to the contract and a few data errors were made.

- A. Experience Scottsdale sets its annual City of Scottsdale performance goals as guaranteed minimums rather than establishing performance expectations. Over the first 4 years of the contract, reported performance results exceeded the goals by 4% to 98%.

The performance measures have remained fairly consistent throughout the contract period, and actual performance for each measure has always exceeded the goal. Each year's measures have been set with a moderate increase to the previous year's goals rather than in relation to the prior year's actual results. For example, the FY 2015/16 goal for convention sales leads was 1,296 and the actual was 1,511. The FY 2016/17 goal was set at 1,356 leads, or 10.3% lower than the previous year's actual results.

Appendix A summarizes all the reported performance measure results.

- B. As reported, some Experience Scottsdale performance measure results are not relevant to the contract, and a few data errors were made.
- As further detailed in Table 2, on page 10, the reported performance results include some activities benefiting the organization's 180 non-Scottsdale members.⁴ However, this activity is not made clear in the reports to the City of Scottsdale. An uninformed reader would understand the reported metrics to represent promotional activities for hotels, restaurants and other service organizations within Scottsdale boundaries.
 - In addition, the Convention performance results include both new and recurring events, although that is not clear in the report. Room nights resulting from recurring events likely would have occurred without Experience Scottsdale intervention. Therefore reporting separately or only for new events would provide a more useful metric.
 - Table 2, on page 10, also identifies the data errors found in Marketing metrics.

For certain performance measures, such as website hits, we analyzed the reports supporting the total measure. For others with a substantial amount of underlying details, such as travel articles generated, we analyzed a sample of the supporting records.

⁴ Of the organization's 411 current members, 164 are located outside the city's boundaries and another 16 are outside Maricopa County boundaries.

Table 2. Selected Performance Measure Results, FY 2015/16

Performance Measure	Goal	Reported	Audited
Convention Sales & Services			
<i>Convention bookings for future dates</i>			
“Audited” excludes bookings for non-Scottsdale properties. However, these counts include events that have long-standing relationships with the City, such as the Barrett-Jackson Auto Auction.	408	536	297
<i>Room nights resulting from convention bookings</i>			
“Audited” excludes bookings for non-Scottsdale properties. However, these counts include events that have long-standing relationships with the City.	114,000	167,056	83,836
Communications			
<i>Travel articles generated</i>			
“Reported” includes travel articles that focused on non-Scottsdale hotels and businesses. For example, an <i>Executive Golfer</i> article focused on Sedona golf resorts but made one mention that the course designer also designed Troon North in Scottsdale.	1,000	1,204	Sampled only
Marketing			
<i>Unique visitors to Experience Scottsdale’s website</i>			
“Reported” included total website visits instead of unique website visitors as shown in “Audited.”	1,000,000	2,644,654	2,069,892
<i>Economic impact associated with visitor inquiries</i>			
The calculation includes visitor inquiry and website visitor data. Total visitor inquiries and website visits were used duplicating repeated contacts. “Audited” excludes the duplicate counts.	\$230,000,000	\$310,554,164	\$261,975,408
<i>Inquiries from high demographic customers in primary and secondary markets</i>			
“Reported” includes all inquiries from the primary and secondary markets, regardless of demographics. Additionally, duplicate customers were included. “Audited” only adjusts for duplicates as demographic information was not available.	27,000	35,127	26,721
Notes: For FY 2016/17 performance standards, economic impact and high demographic inquiries have been replaced by a new metric <i>brand engagement</i> .			

SOURCE: Auditor analysis of Experience Scottsdale performance measure reports, the supporting database and related materials.

C. When promoting or recommending hotels and other tourism related businesses, Experience Scottsdale does not prioritize Scottsdale locations.

- Although Scottsdale Bed Tax provides more than \$9 million of its revenue, Experience Scottsdale staff stated all its members are promoted the same, whether they are in Scottsdale or not.
- Experience Scottsdale generally does not promote Scottsdale businesses that are not members.

The private membership dues provide only about \$330,000 of the organization's total budget. For the large proportion of funding provided, the City may want to require the organization to prioritize Scottsdale businesses in its promotions and responses to inquiries.

Recommendations:

The Contract Administrator should evaluate whether planned performance standards are focused on Scottsdale benefit and propose contract clarifications for the next term. Specifically, consider:

- A. Requiring performance goals be based on the previous year's actual results unless there are known factors supporting lower expectations, such as a change in marketing emphasis.
- B. Adding a contract requirement that performance measures report separately on activities benefiting Scottsdale businesses and those including or primarily benefiting non-Scottsdale business. Additionally, require metrics to be defined, such as specifying unique inquiries and customer contacts. If the City's large recurring events are included in performance results, their impact should be separately identified.
- C. Specifying that Scottsdale businesses, including nonmembers, are prioritized in promotional efforts and responses to inquiries.

2. Financial oversight of the destination marketing contract can be improved.

The Contract Administrator should monitor more closely Experience Scottsdale's financial position and its use of City tax dollars. As well, contract terms can better define allowable uses of City funding.

- A. Experience Scottsdale's reported reserves are most likely partially funded with City revenue and some reported advertising is funded with state tax dollars.

- 1) Financial reserves identified as being from private revenue sources may have actually been funded with City Bed Tax dollars.

Experience Scottsdale's financial statements note three reserve accounts as being funded with cash generated from membership dues and other private sector revenue. However, the City of Scottsdale provides almost 70% of the organization's total revenues.

Most of the organization's expenses are not assigned to specific revenue sources. Instead, Experience Scottsdale considers all its activity Scottsdale-related and uses City of Scottsdale funding first for the unassigned expenses. Therefore, the organization attributes its year-end designated reserves to its private revenue sources.

As discussed in Finding 1, Experience Scottsdale activities also provide substantial benefit to its non-Scottsdale members. Because the organization does not assign specific costs to the applicable benefit (such as Scottsdale/non-Scottsdale member), we analyzed its financial activity by assigning expenses in proportion to the related revenues. The financial records do not categorize member dues based on whether or not the businesses are within Scottsdale boundaries, so we were limited to comparing Scottsdale revenues, other governmental revenues and private revenue sources (member dues and program fees).

As shown in Table 3, private revenues represent from 9.0% to 11.6% of total revenues. These sources have become a smaller proportion as City of Scottsdale Bed Tax steadily increased, as illustrated in Figure 3. After allocating a proportionate amount of expenses to these private revenues, approximately \$85,000 of the remaining net increase may be attributable to private resources.

In contrast, these three reserve accounts have increased by \$369,000 over the same 4-year period.

Figure 3. Experience Scottsdale's Revenue Sources

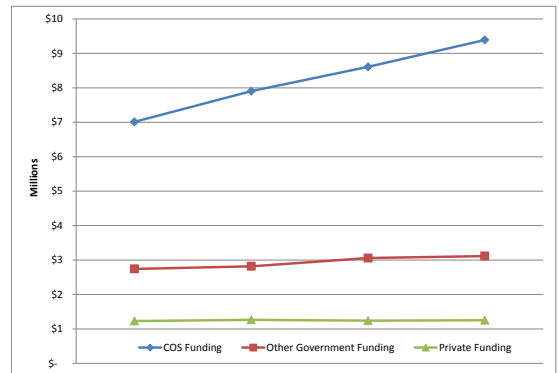


Table 3. Experience Scottsdale Revenue and Expenses

	FY 2012/13	FY 2013/14	FY 2014/15	FY 2015/16	Total
Total Revenue *	\$9,116,000	\$10,100,000	\$10,863,000	\$11,703,000	
Private Revenue	\$1,055,000	\$1,067,000	\$1,040,000	\$1,054,000	
% Private Revenue	11.6%	10.6%	9.6%	9.0%	
Total Expense *	\$9,223,000	\$9,694,000	\$10,776,000	\$11,198,000	
Allocated Private Expense	\$1,067,000	\$1,024,000	\$1,032,000	\$1,008,000	
Net Private Revenue	\$(12,000)	\$43,000	\$8,000	\$46,000	\$85,000
Increase in Reserve Accounts	\$125,000	\$30,000	\$64,000	\$150,000	\$369,000

* State Prop 302 revenue and expense were not included because overhead costs are not allocable to that revenue source. Fort McDowell Yavapai Nation funding, which pays for a specific Native Trails event, and the expense are also excluded.

SOURCE: Auditor analysis of Experience Scottsdale financial statements.

Further, because the City's contract has historically represented a substantial portion of Experience Scottsdale's revenues, it is reasonable to consider a majority of the almost \$1.4 million reserve balance was funded with City Bed Tax dollars.

If the current Bed Tax growth continues, a larger portion of reserves may be attributable to City funding over time. While maintaining a reserve is reasonable to ensure continued destination marketing in the event of an economic downturn, the current contract does not address financial reserves. Policy considerations may include stating the allowability of financial reserves, defining how the amount of remaining Bed Tax is determined and establishing a guideline for how large or small the amount can be. Also, the contract could address the amount of Bed Tax funds to be recovered if the contractual relationship was to terminate.

- 2) When reporting to the City on promotional activities, Experience Scottsdale includes projects paid for with Proposition 302 funds.

The Arizona Office of Tourism, which provides the Proposition 302 tax funds, requires the specific uses of these revenues to be reported, so the funds are segregated in Experience Scottsdale's financial records. This funding, which totals about \$2 million annually, can be used for tourism promotion marketing programs but is prohibited from being used for administrative and salary costs.

Experience Scottsdale includes the Proposition 302-funded advertising in its quarterly reports to the City. Even though this advertising is marketing the City as a destination, the reporting method can inaccurately give the impression that the ads represent a use of City Bed Tax funding. Identifying the Proposition 302 supported advertising would appropriately convey the shared benefit to the City.

- B. Although not a party to the agreement, the City of Scottsdale pays the full cost of Experience Scottsdale's agreement with the Fiesta Bowl organization.

- 1) The Town of Paradise Valley also receives approximately equal benefits from the agreement but does not contribute equally to the cost.

The contract requires that the Fiesta Bowl organization ensure both teams (and one national championship team when applicable) and their related groups lodge in a property that pays either Scottsdale or Paradise Valley Bed Tax. In 2006, when the Fiesta Bowl agreement was first added to the City's contract, City staff's Council Report noted that Paradise Valley contributed \$75,000 and the amount for each party would be negotiated annually.

Although one Fiesta Bowl team has lodged in a Paradise Valley hotel each year, Scottsdale has paid the full Fiesta Bowl contract amount since FY 2007/08. However, Paradise Valley Town Council minutes document a \$75,000 annual contribution toward the Fiesta Bowl contract in July 2008 (FY 2008/09) and June 2010 (FY 2010/11).⁵ In April 2013, the Town Council extended the June 2010 agreement through June 2020 with the same terms.

- 2) The Fiesta Bowl agreement also requires Experience Scottsdale to ensure that Scottsdale provides in-kind (free) police escort services for both teams. The 2006 staff report says the City will provide police escort services not to exceed \$15,000 per year. In fact, the police escort services have ranged from \$73,000 to \$85,000 over the last 4 years, or approximately 5 times more than reported to City Council ten years ago.

⁵ As part of the June 7, 2010, agreement exhibits, the program of work states "Instead of paying the CVB separately for the Town's Fiesta Bowl-related benefits, those benefits will be incorporated as part of this agreement." The FY 2010/11 program specifically lists the \$75,000 contribution.

In a future contract, the terms providing support for the Fiesta Bowl agreement could require that the shared Bed Tax revenues pay the cost or that Scottsdale only pays its proportionate share of the costs.

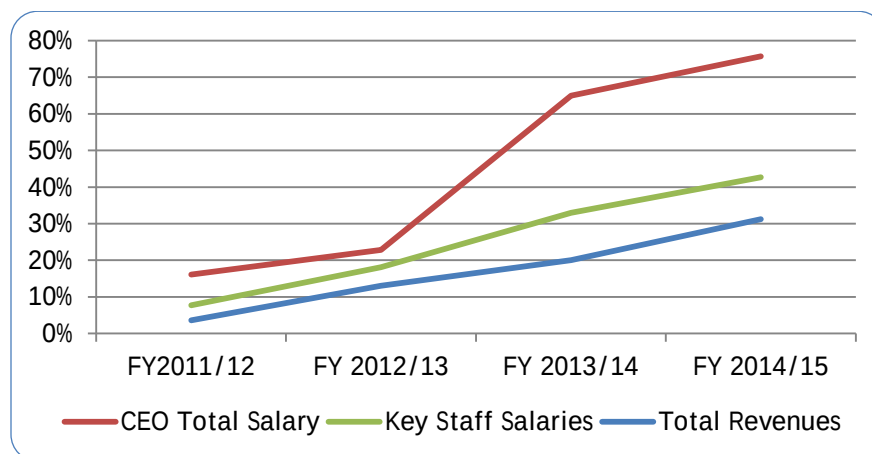
- C. The current destination marketing contract is not specific regarding the allowable uses of Bed Tax funds.

Although the Scottsdale Mayor appoints a Councilmember to represent the City on the Experience Scottsdale Board of Directors, this representative is not on the Board's Executive Committee or its Compensation Committee.⁶ Given the City's substantial investment in Experience Scottsdale, more oversight or guidelines exercised through contract terms may be appropriate. For example:

- 1) Executive compensation represents a substantial use of City revenues and has been rapidly increasing, based on research of publicly available IRS Form 990s.

Compared to FY 2010/11, over the past 4 years the CEO's salary increased by 76%, to \$469,000, while key staff salaries increased 43% and total revenues increased by 31%, as illustrated in Figure 4. The key staff salary increase included two vice president positions added during FY 2011/12 and one executive vice president position deleted during FY 2012/13. Individual key staff increases ranged from 32% to 62% over the applicable 3 or 4 year periods.

Figure 4. Salary Increases Compared to Total Revenue Increase Since FY 2010/11



SOURCE: Auditor analysis of Experience Scottsdale's IRS Form 990s from Guidestar.com. For a not-for-profit organization, these tax forms are required to be available for public inspection.

Currently the CEO's salary is set by a 2-person Compensation Committee comprised of the Executive Committee's Chair and Vice Chair. The CEO establishes the salaries of the other executives (also referred to in this report as "key staff"). The organization reported on its Form 990s that it regularly participates in destination marketing industry compensation surveys and engages third-party human resources

⁶ The Town of Paradise Valley and the Salt River Pima-Maricopa Indian Community also each appoints a representative to the Board of Directors.

professionals to review compensation to ensure it is in line with similar jobs in other industries and within the local region.

- 2) In Experience Scottsdale's proposed budgets and quarterly financial reports given to the City, personnel costs are reported as a single expense line item rather than by function as the other costs are summarized. This presentation has the effect of decreasing the reported overhead costs because the CEO and other general support staff salaries and benefits are not included in the overhead functional category. Requiring the budget and financial reports to assign personnel costs to the associated functions, or programs, would provide more accurate information on the organization's overhead costs.
- 3) While the City's contract with Experience Scottsdale requires these public funds to be spent on destination marketing activities, the only specific use limitation is to restrict the funds from being spent on political activity.

Auditors observed that Experience Scottsdale has implemented its own policies and procedures to ensure reasonable travel and entertainment expenses, such as encouraging the use of coach airfare and moderately priced hotels. Further, the organization has a competitive purchasing policy requiring multiple bids, written quotes, or a formal Request for Proposal based on the amount of the purchase. Based upon expenditure testing, there is reasonable assurance that Experience Scottsdale is following these financial procedures. However, should the organization's internal policies and procedures change, the contract itself provides little definition of allowable uses that the City could enforce.

Providing a definition and examples of allowable and unallowable uses of the Bed Tax funding can help minimize misunderstanding. For example, contract terms could address the allowability of expenses such as employee-only meals, staff parties or receptions, gifts, or first-class travel. Further, the contract could provide a City definition for administrative/overhead cost and establish a limit on overhead expenses relative to the Bed Tax funding.

- D. Although the City has paid Experience Scottsdale \$7 to \$9 million annually, the organization required the City's McCormick-Stillman Railroad Park to pay for its advertisement in the Destination Marketing Guide. Over the past 4 years, the Park has paid more than \$5,600 for its quarter-page sized ad. While a relatively minor cost, during the same time, Experience Scottsdale provided the Scottsdale Cultural Council a free full-page advertisement in the Guide.

Recommendations:

The Contract Administrator should consider including additional terms in future destination marketing contracts, such as requiring that:

- A. Expenses that specifically benefit Scottsdale businesses be separately tracked otherwise expenses will be considered prorated based on funding proportion. Further, terms should be established related to maintaining a reserve from City Bed Tax dollars and its disposition if the contract is terminated or not renewed. Additionally, advertising or other materials paid for by non-Scottsdale funding should be identified when reporting results.
- B. Shared Bed Tax revenues pay the cost for the Fiesta Bowl agreement or that Scottsdale only contributes a proportionate share of the costs, including the value of in-kind police services.

- C. The contract addresses allowable types of costs that can be paid from Bed Tax funds, along with restrictions or guidelines on costs such as travel expenses, compensation and overhead. Additionally, require annual submittal of the IRS Form 990 in order to monitor those highest compensated positions for significant changes.
- D. City of Scottsdale advertisements be included in its publications at no additional cost.

3. Contract administration can be improved.

Administrative Regulation (AR) 215, *Contract Administration*, states that the Contract Administrator is responsible for monitoring all aspects of the contract. Requirements for the destination marketing contract include providing supporting documentation and using a competitive process for procurement.

- A. The Contract Administrator has not required Experience Scottsdale to provide documentation supporting its reported performance measures.

The destination marketing contract requires that Experience Scottsdale provide an annual report at the end of each contract year along with additional supporting materials. Supporting documentation would include detailed information on the year-end performance measures as well as copies of marketing materials purchased with Scottsdale funds.

For the first three years of the contract term, Experience Scottsdale provided a quarterly list of all materials produced, together with a sample of 2 to 3 items. Starting in FY 2015/16, the Contract Administrator and the organization's representatives informally agreed that, due to the time spent to prepare the list, it would no longer be provided. However, to comply with City Procurement Code, changes to the requirements of a Council-approved contract require a Council-approved contract modification. Further, if the Contract Administrator had gone onsite to review the supporting documentation, the issues described in Finding 1 may have been identified and corrected at an earlier stage of the contract term.

- B. The Contract Administrator has not reviewed or approved Experience Scottsdale's purchasing process. The destination marketing contract requires Experience Scottsdale's purchasing processes be performed on a competitive basis that is acceptable to the City's Contract Administrator. However, the Contract Administrator was not aware of the requirement and had not approved its process.

Our review found that the Experience Scottsdale employee handbook provides guidance on purchasing, including a bid process for purchases over \$5,000.

Recommendations:

The Contract Administrator should:

- A. Ensure the new destination marketing contract only includes terms that are necessary and will be enforced. For example, contract terms could instead require the marketing materials to be available for the Contract Administrator to periodically review at the Experience Scottsdale office.
- B. Review and approve in writing Experience Scottsdale's procurement process at the beginning of each contract term.

MANAGEMENT ACTION PLAN

1. Performance measure goals and results could be more relevant.

Recommendations:

The Contract Administrator should evaluate whether planned performance standards are focused on Scottsdale benefit and propose contract clarifications for the next term. Specifically, consider:

- A. Requiring performance goals be based on the previous year's actual results unless there are known factors supporting lower expectations, such as a change in marketing emphasis.
- B. Adding a contract requirement that performance measures report separately on activities benefiting Scottsdale businesses and those including or primarily benefiting non-Scottsdale business. Additionally, require metrics to be defined, such as specifying unique inquiries and customer contacts. If the City's large recurring events are included in performance results, their impact should be separately identified.
- C. Specifying that Scottsdale businesses, including nonmembers, are prioritized in promotional efforts and responses to inquiries.

MANAGEMENT RESPONSE: Agree

PROPOSED RESOLUTION: The Tourism & Events Department will evaluate whether the standards are focused on Scottsdale benefit and will propose needed contract clarifications for the next term. The City Council Report for the FY 2017/18 agreement will address how these issues have been evaluated and the extent to which they are included in the proposed agreement.

RESPONSIBLE PARTY: Contract Administrator Karen Churchard, Tourism & Events Director

COMPLETED BY: 6/30/2017

2. Financial oversight of the destination marketing contract can be improved.

Recommendations:

The Contract Administrator should consider including additional terms in future destination marketing contracts, such as requiring that:

- A. Expenses that specifically benefit Scottsdale businesses be separately tracked otherwise expenses will be considered prorated based on funding proportion. Further, terms should be established related to maintaining a reserve from City Bed Tax dollars and its disposition if the contract is terminated or not renewed. Additionally, advertising or other materials paid for by non-Scottsdale funding should be identified when reporting results.

- B. Shared Bed Tax revenues pay the cost for the Fiesta Bowl agreement or that Scottsdale only contributes a proportionate share of the costs, including the value of in-kind police services.
- C. The contract addresses allowable types of costs that can be paid from Bed Tax funds, along with restrictions or guidelines on costs such as travel expenses, compensation and overhead. Additionally, require annual submittal of the IRS Form 990 in order to monitor those highest compensated positions for significant changes.
- D. City of Scottsdale advertisements be included in its publications at no additional cost.

MANAGEMENT RESPONSE: Agree

PROPOSED RESOLUTION: The Tourism & Events Department will consider including additional terms in future destination marketing contracts. The City Council Report for the FY 2017/18 agreement will address how these issues have been evaluated and the extent to which they are included in the proposed agreement.

RESPONSIBLE PARTY: Contract Administrator Karen Churchard, Tourism & Events Director

COMPLETED BY: 6/30/2017

3. Contract Administration can be improved.

Recommendations:

The Contract Administrator should:

- A. Ensure the new destination marketing contract only includes terms that are necessary and will be enforced. For example, contract terms could instead require the marketing materials to be available for the Contract Administrator to periodically review at the Experience Scottsdale office.
- B. Review and approve in writing Experience Scottsdale's procurement process at the beginning of each contract term.

MANAGEMENT RESPONSE: Agree

PROPOSED RESOLUTION: The Tourism & Events Department will ensure that the agreement only includes terms that are necessary and will be enforced. The Department will also review and approve in writing the procurement process by the beginning of next contract term, and will review and approve when changes are made. The City Council Report for the FY 2017/18 agreement will address how these issues have been evaluated and the extent to which they are included in the proposed agreement.

RESPONSIBLE PARTY: Contract Administrator Karen Churchard, Tourism & Events Director

COMPLETED BY: 6/30/2017

APPENDIX A. REPORTED PERFORMANCE MEASURE RESULTS

	FY 2012/13	FY 2013/14	FY 2014/15	FY 2015/16
Convention Sales & Services				
Convention sales leads for Scottsdale properties	132%	125%	133%	117%
Customer interaction/site inspections for Scottsdale properties	153%	146%	145%	132%
Convention bookings for future dates	115%	122%	128%	131%
Room nights resulting from convention bookings	131%	155%	163%	147%
Product/service leads	135%	136%	125%	115%
Travel Industry Sales				
Tour program leads and services for Scottsdale properties/venues	128%	132%	131%	143%
Targeted clients promoted to	111%	114%	104%	120%
Travel agent impressions via tour operator brochures	131%	111%	126%	123%
Communications				
Travel articles generated	117%	109%	117%	120%
Marketing				
Economic impact associated with visitor inquiries	143%	137%	155%	135%
Inquiries from high demographic customers in primary and secondary markets	114%	124%	127%	130%
Unique visitors to Experience Scottsdale's website	143%	176%	198%	176%

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Councilmember Virginia Korte
Vice Mayor Kathy Littlefield

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