



Office of the City Auditor

Audit of the Virginia Beach Sports Center

Report Date: February 10, 2023

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"Promoting Accountability and Integrity in City Operations"



Office of the City Auditor

"Promoting Accountability and Integrity in City Operations"

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Office of the City Auditor Transmittal Letter

Date: February 10, 2023
To: Patrick A. Duhaney, City Manager
Subject: Audit of the Virginia Beach Sports Center



I am pleased to present the report of our Audit of the Virginia Beach Sports Center. The objective of our audit was to determine whether the Virginia Beach Sports Center operates in compliance with the terms set forth in the management agreement. We completed our fieldwork on November 17, 2022.

The Office of the City Auditor reports to City Council through the Audit Committee and is organizationally independent of all other City Departments. This report is intended solely for the information and use of the Audit Committee, City Council, and appropriate City management. It is not intended to be, and should not be, used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

We would like to thank the management and staff of the Convention & Visitors Bureau and Eastern Sports Management for their cooperation and responsiveness to our requests and questions during our audit.

If you have any questions about this report, or any audit-related issue, I can be reached at 385-5872 or via email at lremias@vbgov.com.

Respectfully submitted,

Lyndon S. Remias, CPA, CIA
City Auditor

LSR/rc

c: Audit Committee Members
City Council Members
Taylor V. Adams, Deputy City Manager
Nancy S. Helman, Director, Convention & Visitors Bureau
Andy Ballard, Vice President, Eastern Sports Management



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Purpose

The purpose of this audit was to determine whether the Virginia Beach Sports Center operates in compliance with the terms set forth in the management agreement. This audit was included in our FY 2023 Audit Plan.

Scope and Objective

The scope of the audit was for the period October 2020 – November 2022.

The objective of the audit was to determine whether adequate documentation existed to support compliance with the terms of the management agreement.

Methodology

To accomplish our objective, we performed the following:

- Interviewed management and staff of the Convention & Visitors Bureau and Eastern Sports Management.
- Reviewed departmental financial data and reports through inquiry and examination of relevant documents and data.
- Performed analysis and tests of data designed to identify trends and high-risk criteria.
- Made recommendations, as appropriate, to ensure compliance with the management agreement and reduce the City's risk to an acceptable level.

Standards

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain enough sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained during this audit provides a reasonable basis for our findings and conclusions based on our audit objective.

The Office of the City Auditor reports to City Council through the Audit Committee and is organizationally independent of all other City Departments. This report will be distributed to the City's Audit Committee, City Council, and appropriate management within the City of Virginia Beach and Eastern Sports Management. This report will also be made available to the public through the Office of the City Auditor's webpage.



Background¹

The mission of the Virginia Beach Convention & Visitors Bureau (CVB) is to develop and promote the City of Virginia Beach as a first-class, year-round travel destination that contributes to the City's quality of life and its diverse economy. Accordingly, the CVB is responsible for facilitating the creation and enhancement of convention, tourism, special events and resort-related improvements to maximize tax revenues. City Council's vision, as explained in Resort Area Strategic Action Plan 2030, is to identify and implement public amenities and infrastructure improvements and update codes, guidelines, and City review processes to encourage private development, enabling the Virginia Beach Resort Area to become a diverse, world-class, year-round coastal community for residents and visitors. One development project which resulted from this vision is the Virginia Beach Sports Center (Sports Center). Table 1 below summarizes the activity relating to sports events hosted by the Sports Center since opening in October of 2020.

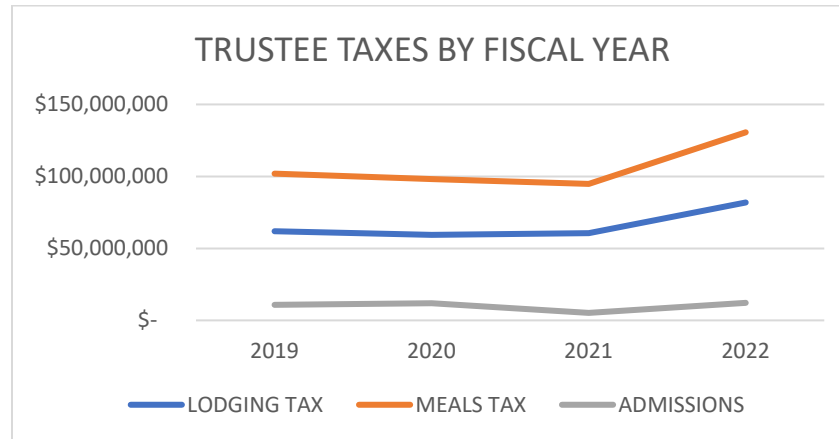


Table 1. Sports Center - Sports Events Summary

	Events	Athletes	Spectators	Comments
FY 2021	41	51,555	58,285	October 2020 through June 2021; COVID-19 restrictions during the period
FY 2022	58	76,187	108,700	July 2021 through June 2022; COVID-19 restrictions during the year
FY 2023	63	85,150	116,279	July 2022 through June 2023; includes estimates which are subject to change
Totals	162	212,892	283,264	

At a project cost of approximately \$68M, the Sports Center was initially funded by the City's Tourism Investment Program Special Revenue Fund which derives its revenues primarily through lodging taxes, meals taxes, and admissions taxes. For fiscal year 2022, lodging, meals, and admissions taxes totaled \$81.9M, \$130.6M, and \$12.2M, respectively. Chart 1 on the following page provides a recent history of the total revenues generated by each of these trustee taxes.

¹ Unless otherwise specified, information was taken from: departmental financial data, reports from City databases (e.g., Oracle Financials Cloud), and <https://www.vbgov.com>.



The Sports Center is a 285,000 square foot indoor sports facility which sits adjacent to the Virginia Beach Convention Center near the Oceanfront. One section of the facility houses twelve premium hardwood basketball courts which can be converted into twenty four volleyball courts. The other section, which contains a 200-meter hydraulically-banked indoor track, is capable of hosting NCAA and World Indoor Track & Field Tournaments. In addition to the sports events previously mentioned, the Sports Center has the versatility to hold many other types of events including wrestling, gymnastics, field hockey, cheerleading, pickleball, cornhole, and more. During its relatively brief existence, the facility is on pace to have welcomed nearly half a million athletes and spectators by the end of the current fiscal year. The Sports Center has hosted a world record performance in the girls U20 4X800 meter relay as well as an all-time indoor pole vault high school state record. While sports events typically take place on Friday and on the weekend, Monday through Thursday the facility space is usually occupied by local leagues and programs. Other notable amenities of one of the largest multi-purpose indoor facilities on the East Coast include seating for 7,000 spectators, a press box, two VIP suites, four multipurpose rooms, a full-service two-story kitchen and café, and an outdoor event space for awards and entertainment.



The Sports Marketing Division of the CVB – one of eight CVB business units – acts as the marketing, booking, and oversight division for the Sports Center. Through a public-private partnership with ESM VBSC, LLC (ESM VBSC), the operations manager, the City has outsourced all day-to-day operations of the Sports Center. ESM VBSC's on-site employees include a general manager, an assistant general manager, a facility director, and other supporting staff. The initial term of the management agreement is for ten years, and ESM VBSC receives a monthly management fee of \$30K, subject to small annual increases for inflation, as well as a revenue-based monthly incentive fee for the operation and maintenance of the Sports Center. ESM VBSC is to remit to the City on a quarterly basis the net income from operations as calculated under Section 4.4 of the agreement. The City evaluates ESM VBSC's performance as an operations manager on both a quarterly and annual basis.

To generate estimated economic impact data for sports events, Sports Marketing is currently utilizing a database management economic impact model offered by Destinations International,



the world's largest resource for official destination organizations, convention and visitors bureaus, and tourism boards. The model incorporates data received from Tourism Economics, a leading independent global advisory firm who combines an understanding of the travel sector with proven economic and analytical tools. Tourism Economics, in turn, collects its data from purchased consumer survey research on travelers, which includes generalized data on spending behaviors, travel party size, and other information broken out by sports

event type. Tourism Economics augments this macro level information with historical event-specific data obtained from internet searches and studies conducted by its task force members. Additionally, Destinations International has partnered with Simpleview, a digital marketing solutions provider. Reporting tools offered by Simpleview allow management to integrate within the model certain items of information which pertain to an actual sports event, such as the number of event participants and hotel room rates for those attendees who anticipate lodging in a City hotel during an event. A partnership overview (POV) agreement, an agreement between the City and the event sponsor, documents several estimated items of information pertaining to an actual event.

Results

Finding 1. Sustainability of Financial Operations Appears Questionable

The sustainability of the Sports Center's financial operations appears to be questionable. Several indicators, noted below, led us to this observation:

- ESM VBSC has been deficient in submitting quarterly financial statements. Only *draft* versions were submitted for the first four quarters of operation and none were submitted for the last four quarters, including the calendar quarter which most recently ended. We have documented the details in Finding 2 below.
- The Sports Center has experienced increasing operational losses in two of the four quarters where the *draft* financial statements were submitted. It is likely that operational losses were trending during this time, in part, because of the following: unanticipated revenue shortfalls due to event cancellations caused by COVID-19 restrictions, increasing ordinary operating costs related to inflation, and difficulty securing qualified help with custodial services.



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- ESM VBSC has depleted the funds in the Operating Reserve account. Section 3.5 of the management agreement establishes an Operating Reserve account to be funded by the City with an initial balance of \$750K. The purpose of this account is to pay unanticipated operating costs incurred by ESM VBSC. The unanticipated operational losses mentioned above was the reason cited for utilizing this account. See Table 2 below for a summary of activity in the Operating Reserve account.

Table 2. Operating Reserve Account Activity

<u>OPERATING RESERVE ACCOUNT ACTIVITY</u>				
INITIAL ACCOUNT BALANCE FUNDED BY CITY				\$ 750,000
LESS: FY 2022 WITHDRAWALS				435,000
LESS: FYTD 2023 WITHDRAWALS (ACTUAL AND PENDING)				315,000
TOTAL WITHDRAWALS				750,000
CURRENT BALANCE				\$ -

- In addition to the Operating Reserve withdrawals, ESM VBSC has requested to borrow \$260K from the City through Section 5.3 of the management agreement which addresses insufficient funds. Again, unanticipated operational losses was the reason noted for the supplemental funding.
- The order of repayment by ESM VBSC has not yet been determined. Most likely, however, before the Operating Reserve account and funds acquired due to insufficient funds can be repaid by ESM VBSC, the Working Capital account must first be replenished to its initial funding level of \$400K so sufficient working capital is available for current operations. The Working Capital account was initially funded by ESM VBSC, but will be replenished by the City. See Table 3 below which compares the beginning fund balance in this account to the balance on the last day of fieldwork.

Table 3. Working Capital Account Fund Balance

<u>WORKING CAPITAL ACCOUNT</u>				
BEGINNING		FUND BALANCE AS OF 11/17/22 -		
	FUND BALANCE		LAST DAY OF FIELDWORK	DIFFERENCE
FUND BALANCE	\$400,000		\$29,000	\$371,000

- During the audit period, ESM VBSC transitioned to a new general manager of the Sports Center.



Collectively, the indicators noted above pose a critical threat to the financial sustainability of the Sports Center. Management and ESM VBSC must immediately find solutions to address these issues.

Recommendations:

Management should:

- 1.0** Work closely with ESM VBSC to identify ways to increase operating revenues. This includes, but is not limited to, hosting sports events which generate the greatest long-term economic impact, maximizing the number of sports events hosted during the summer months, selecting optimal price points for all revenue streams, and minimizing the quantity and amount of discounts offered to sports event sponsors.
- 1.1** Work closely with ESM VBSC to identify ways to decrease operating expenses without sacrificing the quality of services.
- 1.2** For funds provided to ESM VBSC due to insufficient funds, in accordance with Section 5.3 of the management agreement:
 - Suspend payment of the incentive fee to ESM VBSC until funds provided by the City have been returned.
 - Require from ESM VBSC a six month plan to meet the operating expenses of the Sports Center and, if they fail to meet the expenses after six months from the receipt of the insufficient funds notification, deem such an occurrence an event of default by ESM VBSC under Section 8.1.(a) of the management agreement.

Finding 2. Deficiencies in the Submission of Quarterly Financial Statements

ESM VBSC has been deficient in submitting the Sports Center's quarterly financial statements to the City. Section 4.5 of the management agreement requires ESM VBSC to provide the City a quarterly financial statement covering all income and expenses related to the Sports Center for the preceding quarter. Based on our review, we found that:

- Only *draft* quarterly financial statements have been provided since the inception of the Sports Center in October of 2020 through the third calendar quarter of 2021. *Draft* financial statements are temporary in nature and can still change, pending final review or receipt of additional information. Thus, management can only place conditional, but not firm, reliance on them.



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- No quarterly financial statements were provided for the last four calendar quarters, which is a violation of the agreement.

Table 4 below shows the status of the quarterly financial statements.

Table 4. Status Of Quarterly Financial Statements

STATUS OF QUARTERLY FINANCIAL STATEMENTS				
STATUS				
CALENDAR				NOT
QUARTER	FINAL	DRAFT		RECEIVED
2020				
Q4		X		
2021				
Q1		X		
Q2		X		
Q3		X		
Q4				X
2022				
Q1				X
Q2				X
Q3				X*
*As of 11/17/22 - last day of fieldwork				

In addition to the general-purpose financial statements themselves, the quarterly financial statement is needed because it includes important supplementary information such as:

- Net operating income for calculation of quarterly payments by ESM VBSC – Section 4.4 of the management agreement requires that any net operating income be paid to the City no later than 30 days after the end of each quarter.
- Incentive fee calculation – Section 4.3 of the management agreement describes how the incentive fee payable to ESM VBSC is to be calculated based on gross revenues.

Factors which contributed to deficiencies in submitting financial statements include reporting on a GAAP basis, accounting for the incentive fee, and accounting for the repayment of City funds.

Absence of a finalized quarterly financial statement precludes management from correctly evaluating the health of the business, recalculating amounts due to the City and other fees, and making informed business decisions affecting business operations.

Recommendation:

Management should:

- 2.0** Ensure that quarterly financial statements are received from ESM VBSC timely and document any instances of default by ESM VBSC as outlined in Section 8.1.(a) of the management agreement.



Finding 3. Operations Manager Failing to Meet Expectations

The City concluded in its last two quarterly reviews that ESM VBSC has not met performance expectations, specifically in the category of maintenance. The City has not yet performed the review for the third quarter of 2022.

- Section 4.6 of the management agreement requires the City to provide a quarterly review of ESM VBSC's performance as operator of the facility.
- Section 4.7 requires an annual review which is based on the preceding four quarterly reviews.

Performance ratings are given in the following categories: facility utilization, cleanliness, maintenance, staffing levels, customer service, and communication. Table 5 below shows a summary of these periodic reviews.

Table 5. Summary Of Periodic Reviews Of ESM VBSC By The City

PERIODIC REVIEWS OF ESM VBSC BY THE CITY						
REVIEW	REVIEW	REVIEW	EXPECTATIONS			
PERIOD	ISSUED (YES/NO)	SIGNED (YES/NO)	MET (YES/NO)	REASON FOR A "NO" RATING UNDER EXPECTATIONS MET		
2020						
QE 12/31/20	NO	N/A	N/A	NO REVIEW PROVIDED - CRITERIA STILL BEING ESTABLISHED		
2021						
QE 3/31/21	YES	YES	YES			
QE 6/30/21	YES	YES	YES			
QE 9/30/21	YES	YES	YES			
QE 12/31/21	YES	YES	YES			
YE 12/31/21	YES	YES	YES			
2022						
QE 3/31/22	YES	NO	NO	NOT MEETING EXPECTATIONS IN THE CATEGORY OF MAINTENANCE		
QE 6/30/22	YES	NO	NO	NOT MEETING EXPECTATIONS IN THE CATEGORY OF MAINTENANCE		
QE 9/30/22	NO*	N/A	N/A			
*As of 11/17/22 - last day of fieldwork						

Maintenance deficiencies noted in the last two quarterly reviews include failing to perform regular inspections of the facility and failing to meet Level 1 standards of the Association of Physical Plant Administrators (APPA) for custodial services as required by the management agreement.

Failure of ESM VBSC to meet expectations jeopardizes the ability of the business to achieve its objectives and introduces the risk of interruption of business operations.

Recommendations:

Management should:

- 3.0** Formally place ESM VBSC in a probationary status as outlined in Section 8.1.(b) of the management agreement.



- 3.1 Consider terminating the contract as outlined in Section 8.3.(a) of the management agreement if ESM VBSC fails to meet expectations in any of the four successive quarters after placement in a probationary status.
- 3.2 Perform the third quarter 2022 review immediately, considering the poor results of the last two quarterly reviews.
- 3.3 Perform subsequent quarterly reviews timely.

Finding 4. Economic Impact of Sports Events Is Not Accurately Measured

The economic impact of sports events is not accurately measured, which may prevent booking subsequent events that will maximize the economic impact to the City as outlined in Section 3.7 of the management agreement.

During our review, we observed that the estimated economic impact data – the estimated direct business sales impact and the related direct local tax impact – calculated by the current economic impact model seemed unreasonable. We believe this was the result of the model's use of generalized data derived from the process described earlier. Management concurred and stated, that for this reason, it has refrained from publicly disclosing the calculated economic impact of sports events.

We also noted that certain items of information from the POV agreement, if integrated within the model via Simpleview, may produce more reasonable estimated economic impact data. One such piece of information is the number of spectators per participant. Since this piece of information directly impacts the total number of attendees for a sports event, it is a primary driver of estimated economic impact data. Tables 6 through 8 on the following page illustrate the differences in the estimated economic impact data depending on the source of this information for various examples from three different sports event types: youth amateur, adult amateur, and college.



2021 VIRGINIA SHOWCASE						2022 TEAMMATE NATIONAL CHAMPIONSHIPS						
Event Name						YOUTH AMATEUR						
Event Type									YOUTH AMATEUR			
Event Date			1/14/21-1/17/21			6/22/22-6/26/22						
Using						Using						
			Model Formula		Using POV		Model Formula			Using POV		
			for <i>Spectators</i>		for <i>Spectators per</i>		%		for <i>Spectators</i>			
			<i>per Participant</i>		<i>Participant</i>		Variance		<i>per Participant</i>			
									<i>Participant</i>			
Participants			2,000		2,000		4,500			4,500		
<i>Spectators per Participant</i>			<i>2.3</i>		<i>0.4</i>		<i>2.3</i>			<i>2.2</i>		
Spectators			4,600		800		-83%			-3%		
Attendees (Participants + Spectators)			6,600		2,800		14,850			14,500		
Direct Business Sales			\$ 3,341,941		\$ 1,389,460		\$ 11,397,665			\$ 11,121,868		
Direct Local Tax Impact			\$ 153,702		\$ 65,097		-58%			-2%		

Event Name				2021 MID-ATLANTIC CORNHOLE PROVING GROUNDS			2022 CHARM CITY BASH				
Event Type				ADULT AMATEUR			ADULT AMATEUR				
Event Date				12/3/21-12/5/21			8/20/22-8/21/22				
Using							Using				
				Model Formula		Using POV		Model Formula		Using POV	
				for <i>Spectators</i>		for <i>Spectators per</i>		for <i>Spectators</i>		for <i>Spectators per</i>	
				<i>per Participant</i>		<i>Participant</i>		<i>per Participant</i>		<i>Participant</i>	
Participants				500		500		504			
<i>Spectators per Participant</i>				<i>1.5</i>		<i>2.0</i>		<i>1.5</i>			
Spectators				750		1,000		756		50	
						33%		-93%			
Attendees (Participants + Spectators)				1,250		1,500		1,260			
								554			
Direct Business Sales				\$ 407,069		\$ 482,616		\$ 725,390			
								\$ 334,315			
Direct Local Tax Impact				\$ 20,307		\$ 24,345		\$ 48,185			
						20%		\$ 21,246			
								-56%			

Event Name				2022 MEAC INDOOR TRACK CHAMPIONSHIPS			
Event Type				COLLEGE			
Event Date				2/21/22-2/23/22			
Using							
				Model Formula	Using POV		
				for <i>Spectators</i>	for <i>Spectators per</i>	%	
				<i>per Participant</i>	<i>Participant</i>	Variance	
Participants				480	480		
<i>Spectators per Participant</i>				<i>0.6</i>	<i>2.1</i>		
Spectators				288	1,000	247%	
Attendees (Participants + Spectators)				768	1,480		
Direct Business Sales				\$ 146,708	\$ 274,950		
Direct Local Tax Impact				\$ 7,912	\$ 15,197	92%	



Sports events generate considerable tax revenues for the City. Not accurately measuring each event's economic impact is inconsistent with the goal of maximizing the economic impact to the City and could result in future tax revenue losses.

Recommendation:

Management should:

- 4.0** Integrate items of information available from the POV agreement into the current economic impact model to calculate the estimated economic impact data, when possible, instead of relying on estimates based on generalized data which are embedded within the model.

Conclusion

Overall, we determined that the Virginia Beach Sports Center, except as noted above, is operating in compliance with the terms of the management agreement.

Acknowledgements

We would like to thank the management and staff of the Convention & Visitors Bureau and Eastern Sports Management for their cooperation and responsiveness to our requests, questions, recommendations, and suggestions.



INTER-OFFICE MEMORANDUM

DATE: January 12, 2022

TO: Lyndon Remias, City Auditor

FROM: Taylor Adams, Deputy City Manager
Nancy Helman, Director of Convention and Visitors Bureau

SUBJECT: Management Response to the Audit of the Virginia Beach Sports Center

We appreciate the time and efforts of the City Auditor staff in conducting their audit of the City's Virginia Beach Sports Center and providing us with a value-added report for all involved. The Sports Center operates within the framework of the Convention & Visitors Bureau Sports Tourism Unit. The Sports Center has more than met the expectations of the City through the number of events, athletes, and revenues coming in for the area's hotels, retail, and transportation. Overall, we agree with your findings and recommendations and offer the responses as below.

Finding 1. Sustainability of Financial Operations Appears Questionable

Recommendations:

Management should:

- 1.0 Work closely with ESM to identify ways to increase operating revenues. This includes, but is not limited to, hosting sports events which generate the greatest long-term economic impact, maximizing the number of sports events hosted during the summer months, selecting optimal price points for all revenue streams, and minimizing the quantity and amount of discounts offered to sports event sponsors.

Response: Management will review and determine the optimal price points considering the impact of inflation and on ESM VBSC's financial standing. Additionally, moving forward, the discounts (also called retail rate adjustments) given by CVB to event organizers will be paid to ESM VBSC that otherwise would negatively impact the Sports Center working capital.

Due to very high hotel occupancy rates and much higher hotel room costs limits how many sports events can be held during the summer months. Availability of affordable lodging for spectators and families of event participants is low during those months. It is also difficult to block hotel rooms during the tourist season. Additionally, the outdoor season lasts into November to where there is little or no activity in the Sports Center. It was/is expected that ESM VBSC to work with local organizers to create local programming events and activities in order to maximize revenue during the summer months.

As always, we do continue to seek and generate exciting sports events to bring to the City, including the Sports Center. Many of our successful events are annual sports events and we strive to build on that to fully utilize the Virginia Beach Sports Center year around. We truly want to make the Sports Center a place 'Where Legends Rise!'

- 1.1 Work closely with ESM to identify ways to decrease operating expenses without sacrificing the quality of services.

Response: Management will review ESM VBSC management's plan to identify areas of operating expenses that can be reduced without negatively affecting the quality of services and staffing levels needed for effective operations of events, customer service, and maintenance and repairs of the facility. This may include ESM VBSC to establish a full-time in-house staff to adhere to the Exhibit E (of the agreement) show-piece level of maintenance and custodial requirements and to not rely on expensive contracted custodial staff.

- 1.2 For funds provided to ESM due to insufficient funds, in accordance with Section 5.3 of the management agreement:
 - Suspend payment of the incentive fee to ESM until funds provided by the City have been returned.
 - Require from ESM a six-month plan to meet the operating expenses of the Sports Center and, if they fail to meet the expenses after six months from the receipt of the insufficient funds notification, deem such an occurrence an event of default by ESM under Section 8.1.(a) of the management agreement.

Response: Management will request ESM VBSC to suspend the incentive fee payments until all operating reserve withdrawals and the insufficient funds funding has been repaid to the City.

Management will also request from ESM VBSC a six-month plan to meet the operating expenses of the Sports Center and work with ESM VBSC to do so as noted in our response to 1.1 above.

Finding 2. Deficiencies in the Submission of Quarterly Financial Statements

Recommendation:

Management should:

- 2.0 Ensure that quarterly financial statements are received from ESM timely and document any instances of default by ESM as outlined in Section 8.1.(a) of the management agreement.

Response: Management will monitor the timing of receipt of the ESM VBSC financial statements and document any instances of default in accordance with the agreement. Management will request the financial statements to be received by us within thirty (30) days after the quarter-end to enable prompt review, analysis, and action, if needed, to address issues noted therein. Also, copies of the financial statements will be forwarded to the City's Finance department for their added review.

Finding 3. Operations Manager Failing to Meet Expectations

Recommendations:

Management should:

- 3.0 Formally place ESM in a probationary status as outlined in Section 8.1.(b) of the management agreement.

Response: Management with the assistance of the Office of the City Attorney (Legal) will formally notify ESM VBSC of their probationary status. This notification will emphasize the importance of maintaining adherence to the agreement and cure any default of the agreement.

- 3.1 Consider terminating the contract as outlined in Section 8.3.(a) of the management agreement if ESM fails to meet expectations in any

of the four successive quarters after placement in a probationary status.

Response: Consistent with the probationary status, Management and Legal will review the process of terminating the contract with ESM VBSC if the requirements of the contract continues to not be met (default) following the notification of probationary status. However, it should be noted that the City still has discretion to waive the default if it is deemed to be in the best interests to continue with the contractual relationship. Management is working with ESM/ESM VBSC to help them successfully come out of probationary status while not interfering with their daily operations and responsibilities in the agreement.

- 3.2 Perform the third quarter 2022 review immediately, considering the poor results of the last two quarterly reviews.

Response: Management has completed the third quarter performance review and will meet with ESM VBSC shortly. The maintenance aspect of 3rd Quarter performance shows improvement from the prior two (2) quarters.

- 3.3 Perform subsequent quarterly reviews timely.

Response: Management will perform the quarterly reviews within thirty (30) days after the last day of the previous quarter. Information needed for timely completion of the reviews are now received promptly with ESM VBSC's assistance.

Finding 4. Economic Impact of Sports Events Is Not Accurately Measured

Recommendation:

Management should:

- 4.0 Integrate items of information available from the POV into the current economic impact model to calculate the estimated economic impact data, when possible, instead of relying on estimates based on generalized data which are embedded within the model.

Response: We partly concur. Management feels it best to continue to use the industry standard that is embedded within the model and is used extensively by other DMOs throughout the country. This provides an apples-to-apples comparison when working, reporting,



and meeting with other industry representatives. We will use POV information on as-needed basis but in any case, all such event economic impact data is for internal use only and not for public release.



DATE: January 17, 2022

TO: Lyndon Remias, City Auditor

FROM: John Wack, President, Eastern Sports Management
Andy Ballard, Vice President, Eastern Sports Management

SUBJECT: Management Response to the Audit of the Virginia Beach Sports Center

We appreciate the time and efforts of the City Auditor staff in conducting their audit of the City's Virginia Beach Sports Center. Calibrating after coming together is an essential part of the path to success in any partnership.

There have been many successes and some challenges in the first 24 months of operations. We believe that our partnership with the City and the clarity of the goal are as strong as ever at VBSC.

There were many conversations during ESM's Management Agreement negotiations with City staff about the goals of VBSC as it pertains to the management of the building. Much of the discussion centered around working towards zero subsidy while generating as much tourism tax dollars as possible. The strategy discussed to achieve this included a healthy mix of in-house tournaments (high margin events) and a concerted effort to demand retail pricing from all customers.

When the facility opened in the middle of the Pandemic, Virginia's rules for events and gathering were less restrictive than many northern states. 2021 saw a rush of events from those states to VBSC, as well as an incredibly successful sales effort on the part of the CVB. The need to quickly revitalize the City's pandemic-damaged tourism industry led to aggressive pricing of the use contracts. The pandemic and market conditions have brought us to a different place than what was envisaged by both parties during the negotiation of the Management Agreement.

Currently Sports Marketing controls the calendar for the facility and has done a great job of filling the peak and shoulder season dates of the facility. The economic impact of the Sports Center over the first 24 months of operations has



been estimated to be \$132,000,000. The strategy of using aggressive pricing models to attract the greatest number of events has been a major contributing factor to the economic impact achieved. The pricing strategy has in part led to a shortfall between revenues and operating expenses. Additionally, the successful sales effort has consumed much of the event inventory making it difficult to run the in-house higher margin events planned originally.

After the first year of operations, ESM staff still had the goal of achieving positive cash flow and started to staff as thin as possible to keep costs down. High traffic from events and a post-Covid staffing reality have caused facility operations to be stressed. ESM was given clear direction from the CVB recently that the facility condition is the highest priority. Subsequently, ESM has reorganized the staff and is currently ramping up to this objective as the highest priority.

The economic impact created by Sports Marketing is such that ESM agrees with the CVB's focus on retention of clients through superior customer service and maintaining an elite facility. ESM recommends amending the Management Agreement with ESM to reflect the operating realities that have evolved in the successful creation of the considerable economic impact of the Sports Center during the first two years of operation. Under the current pricing and maintenance model, with the current debt service, Expenses will exceed Revenue. The Agreement should not hold ESM accountable for aspects of the financial sustainability which result from the current sales, pricing and maintenance model. ESM will submit proposed revisions to the Agreement for review. The team (ESM and CVB) will still drive towards reducing and potentially eliminating the subsidy. Until that date, the City should plan to fund the monthly subsidy.

The auditor's report mentions the delay in submission of quarterly reports. There have been a number of aspects of the accounting and the calculation of the Incentive Fee that required that reports already completed be re-calculated and reports under production to be halted and delayed. Those discussions have all been resolved. There will be no more delays in report submission.

The report also suggests that ESM be placed on probation and that the Incentive Fee payments be suspended. While the Management Agreement does allow the City to place ESM on probation if the Reserve Funds are fully utilized, the need



for the funds was the result of factors outside of ESM's control: the Pandemic and the sales and pricing strategy. Also, ESM has not yet been actually paid any of the Incentive Fee. The invoices are entered into VBSC and are reflected in the quarterly report, but no payments have been made. This delay was caused by the ongoing discussions about fee calculations that have now been resolved. ESM has submitted those invoices to the CVB for payment.

The report also suggests that the CVB and ESM work towards closing the gap between revenue and expense. We look forward to working with the CVB to bring contract values higher as they come up for renewal in coming years and finding appropriate inventory to continue to grow the in-house events that we've managed to create.

ESM has been a good partner through the first two years of operation of VBSC. We have worked through the communication issues created as the CVB and ESM learned each other's processes. CVB leadership has stated maintaining the facility at an elite level to generate the highest economic impact as the primary goal and financial performance as a secondary goal. ESM has adapted their strategy to this direction and is currently restructuring to meet those expectations.

Sincerely,

A handwritten signature in black ink, appearing to read "John Wack", is written over the typed name.

John Wack
President
Eastern Sports Management