



AUDIT AND ADVISORY SERVICES

Intercollegiate Athletics – Revenue Recognition Audit Project No. 15-653

October 23, 2015

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October 23, 2015

John Wilton
Vice Chancellor
Administration and Finance

Vice Chancellor Wilton:

We have completed our audit of Intercollegiate Athletics – Revenue Recognition as per our annual service plan in accordance with the Institute of Internal Auditors' *Standards for the Professional Practice of Internal Auditing* and the University of California Internal Audit Charter.

Our observations with management action plans are expounded upon in the accompanying report. Please destroy all copies of draft reports and related documents. Thank you to the staff of Intercollegiate Athletics for their cooperative efforts throughout the audit process. Please do not hesitate to call on Audit and Advisory Services if we can be of further assistance in this or other matters.

Respectfully reported,

Wanda Lynn Riley
Chief Audit Executive

cc: Athletic Director Michael Williams
Associate Vice Chancellor and Chief Financial Officer Rosemarie Rae
Intercollegiate Athletics Chief Financial Officer David Secor
Assistant Athletic Director Caroline Kingsdorf
Senior Vice President and Chief Compliance and Audit Officer Sheryl Vacca
Associate Chancellor Nils Gilman
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University of California, Berkeley
Audit and Advisory Services
Intercollegiate Athletics – Revenue Generation

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OVERVIEW

Executive Summary

The purpose of our audit was to evaluate Intercollegiate Athletics (IA)'s current processes and controls to ensure appropriate recognition and reporting of revenue streams to internal and external stakeholders. We conclude that IA's current processes and controls appear adequate to ensure appropriate recognition and reporting of revenues associated in our scope: ticket sales (including Endowed Seating Program [ESP] seat sales, premium ticket bundles, season tickets, and season game tickets) and contributions.

With respect to the current version of the financing model for California Memorial Stadium (CMS) and the Simpson Student-Athlete High Performance Center (SAHPC), which employs a combination of historical performance and forward looking projections on several categories of revenues (ESP seat sales, non-ESP premium seat sales, facilities rentals, media revenue, philanthropy, and investment earnings on funds functioning as endowment [FFE]) to project cash flows and FFE balances used to service and repay long-term debt issued to finance CMS and SAHPC, we identified the following process improvement opportunities:

- The projected annual outflows of the FFE cover only debt service and repayment of principal but not any associated administrative support or operational costs. Inclusion of relevant administrative and operational costs associated with the ESP or other pledged revenue streams would provide a more balanced view of the annual net position for management and would be consistent with current practices of withdrawals from the FFE in FY13 and FY14 to cover operating expenses.
- There is non-trivial risk that an earthquake or other catastrophic event may render CMS unusable for a prolonged period which may affect one or more of the revenue streams included in the financing model. The campus should consider the impact of a temporary interruption of income streams associated with this possibility and whether risk mitigation measures are warranted, such as the purchase of external business interruption insurance.
- Payments made by seat holders in the ESP are allocated by IA between two FFEs: one which contains funds used to pay for current and future benefits provided to seat holders (season ticket, parking, media guide, food, beverages, etc.) and another which contains the charitable contribution portion of their payment. IA has not completed a long-run projection for annual cash inflows and outflows for the benefits FFE as it has with the contribution FFE. A long-term financial model for the benefit FFE would help provide management with a greater understanding of potential outcomes under scenario modeling and stress testing therefore allowing for more informed decision making.

Management agrees with our observations and has proposed action plans that we believe are responsive to our observation and should incrementally reduce identified risks.

Source and Purpose of the Audit

The purpose of our audit was to evaluate IA's current processes and controls to ensure appropriate recognition and reporting of revenue streams.

Scope of the Audit

In order to understand the categories of IA revenue, we obtained and inspected IA's Statement of Revenue and Expenses for the year ended June 30, 2014, which is reviewed annually by KPMG LLP under an agreed-upon procedure to assist management in evaluating whether the information therein is in compliance with National Collegiate Athletic Association (NCAA) Bylaw 3.2.4.16. IA reported \$90.3 million in operating revenue for the year ended June 30, 2014. We met with IA management to obtain their perspectives on the different reported streams of revenue.

Based upon this understanding, we included the following revenue streams (with percentage of total operating revenue in parentheses) in our scope:

- Ticket Sales including ESP seat sales, premium ticket bundles, season tickets, and single game tickets (16%)
- Contributions (25%)
- Sports Camps (<1%)

The following revenue areas were excluded from our scope and further explanation for why they were excluded are provided below:

- NCAA/Conference Distributions (25%) – Determined externally by contractual arrangement.
- Endowment and Investment Income (15%) – Determined externally by endowment and investment performance.
- Royalties, Advertisements and Sponsorships (10%) – Audit and Advisory Services (A&AS) conducted recent audits both of sponsorship and royalties/licensing revenues.
- Direct Institutional Support (4%) – Small percentage. Determined through campus budget process.
- Program/Novelty/Concessions (2%) – Small percentage. A&AS conducted a recent audit of the prior food concession vendor for football and basketball.
- Student Fees (2%) – Small percentage. A&AS will conduct an audit of student fees in FY16.
- Guarantees (<1%) – Small percentage. Determined externally by contractual arrangement.
- Other (1%)

As part of the bylaw requirements for NCAA Division I membership, the campus is required to "submit financial data detailing operating revenues, expenses and capital related to its intercollegiate athletics program to the NCAA on an annual basis."¹ In addition, the campus is

¹ National Collegiate Athletic Association, *2014-25 NCAA Division I Manual*, Bylaw 3.2.4.16.

required to retain an independent accountant to “verify the accuracy and completeness of the data prior to submission to the institution’s chancellor or president and the NCAA.”²

We reviewed the minimum agreed-upon procedures established by the NCAA that independent accountants are required to use to evaluate the accuracy of revenues and expenses reported. We then obtained and inspected KPMG LLP’s report on applying these agreed-upon procedures which was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants (AICPA). Based upon this review and discussions with management, we did not focus our audit on validating revenue amounts reported to the NCAA and evaluated by KPMG LLP. Rather, for three revenue streams in scope (ticket sales, contributions and sports camps³), we focused on understanding the design of business processes and internal controls to ensure that these transactions are appropriately processed and recorded and that the risk of misappropriation of assets is appropriately mitigated.

Our audit approach consisted of process walkthroughs, documentation review, and interviews with management related to the end-to-end processes for ticket sales and contributions. We also reviewed documentation and presentations provided to the Regents on the status of the CMS renovation and construction of the SAHPC.

We did not conduct testing nor do we opine herein on the compliance with university policies of FFEs associated with the ESP . In addition, we conducted an audit of FFEs in 2011.

Background Information

Ticket sales and contributions comprise 41% of IA operating revenues for the year ended June 30, 2014. Tickets sales are defined by the NCAA as “revenue received for sales of admissions to athletic events” and include “ticket sales to the public, faculty and students, and money received for shipping and handling of tickets.”⁴ Campus ticket sales are comprised of single-game sales, season ticket sales, other ticket packages (such as sales of non-ESP premium seats,), and ESP seat sales (after subtracting the charitable contribution value that is in excess of the ticket face value or fair market value). The largest source of ticket sales is for the football program followed by the men’s basketball program.

Contributions are defined by the NCAA as “amounts received directly from individuals, corporations, associations, foundations, clubs or other organizations that are designated restricted or unrestricted by the donor for the operation of the athletics program.” Amounts paid in excess of a ticket’s value are reported in this category. Pledges are not reported until funds are allocated.⁵

² Ibid.

³ We learned during the course of our audit that sports camps have been substantially outsourced and thus we conducted only limited analysis as revenue streams were largely determined by contractual agreement.

⁴ NCAA, *Agreed-Upon Procedures*, August 15, 2013

⁵ We understand that the NCAA reporting guidance here may differ from GASB revenue recognition and reporting guidance with respect to charitable pledges. The UC Accounting Manual (Section G-327-66, Gifts: Recording of Pledges) states that “GASB 33 requires that promises of private donations should be recognized as receivables and revenue in the accounting period in which they are verifiable, measurable, probable of collection, and all applicable eligibility requirements have been met.”

Summary Conclusion

We conclude that IA's current processes and controls appear adequate to ensure appropriate recognition and reporting of revenues associated in our scope: ticket sales (including ESP seat sales, premium ticket bundles, season tickets, and season game tickets) and contributions.

With respect to the current version of the financing model for CMS and SAHPC, which employs a combination of historical performance and forward looking projections on several categories of revenues (ESP seat sales, non-ESP premium seat sales, facilities rentals, media revenue, philanthropy, and investment earnings on FFE) to project cash flows and FFE balances used to service and repay long-term debt issued to finance CMS and SAHPC, we identified the following process improvement opportunities:

- The projected annual outflows of the FFE cover only debt service and repayment of principal but not any associated administrative support or operational costs. Inclusion of relevant administrative and operational costs associated with the ESP or other pledged revenue streams would provide a more balanced view of the annual net position for management and would be consistent with current practices of withdrawals from the FFE in FY13 and FY14 to cover operating expenses.
- There is non-trivial risk that an earthquake or other catastrophic event may render CMS unusable for a prolonged period which may affect one or more of the revenue streams included in the financing model. The campus should consider the impact of a temporary interruption of income streams associated with this possibility and whether risk mitigation measures are warranted, such as the purchase of external business interruption insurance.
- Payments made by seat holders in the ESP are allocated by IA between two FFEs: one which contains funds used to pay for current and future benefits provided to seat holders (season ticket, parking, media guide, food, beverages, etc.) and another which contains the charitable contribution portion of their payment. IA has not completed a long-run projection for annual cash inflows and outflows for the benefits FFE as it has with the contribution FFE. A long-term financial model for the benefit FFE would help provide management with a greater understanding of potential outcomes under scenario modeling and stress testing therefore allowing for more informed decision making.

SUMMARY OF OBSERVATIONS & MANAGEMENT RESPONSE AND ACTION PLAN

Financing Models for California Memorial Stadium and Simpson Student-Athlete High Performance Center

Observation

Intercollegiate Athletics employs a financial model to estimate and project sources of revenues and expenses, as well as net changes to an associated FFE, related to the issuance and repayment of long-term campus debt incurred for the renovation of California Memorial Stadium and the construction of the Simpson Student-Athlete High Performance Center (the CMS/SAHPC financing model). These models extend through 2053 at which time it is expected that the all principal balances will be repaid.

As with any model that extends out for this length of time, it employs a combination of historical performance and forward looking projections based on certain assumptions on revenues, expenses, investment returns, and external conditions. The original financing model was developed under the direction of the prior Athletic Director in 2009. The model was revised in fall 2012 by IA to reflect actual ESP seat sales through 2011 and revised forward looking projections of seat sales. In spring 2012, the Vice Chancellor for Administration and Finance asked a select group of faculty from the Haas School of Business to review the financial model. Their report was issued in March 2013.⁶

We observe that the CMS/SAHPC financing model currently used remains basically unchanged from 2013. We obtained an understanding of the current state of revenue sources included in the financial model as of spring 2015 and how they may differ from the version of the model evaluated by Haas faculty in late 2012 and early 2013. Based upon this understanding, we observe the following process improvement opportunities for future versions of the financial model:

- As noted in the 2013 Haas faculty report, the projected annual outflows of the FFE cover only debt service and repayment of principal but not any administrative support costs associated with servicing the debt, operational costs associated with the ESP sales team or other pledged revenue streams (media revenue, leasing, rentals, etc.), or administrative costs associated with the operation of the FFEs by the Berkeley Foundation⁷. We believe inclusion of relevant operational costs associated with the ESP or other pledged revenue streams would provide a more balanced view of the annual net position for management and would be consistent with current practices of withdrawals by IA from the FFE in FY13 and FY14 to cover operating and other programmatic expenses over and

⁶ Fuchs, William, Richard Stanton, and Nancy Wallace. *Evaluation of Financing for U.C. Berkeley's California Memorial Stadium and Simpson Center for Student-Athlete High Performance*. March 29, 2013.

⁷ The financing model assumes a 6% average annual investment return on balances in the contribution FFE. As any operational costs or management fees associated with the FFE are not currently included in the annual cash outflow projections, we note that the effective average annual investment return would necessarily need be higher than 6% to generate a net annual return of 6% utilized in the model.

above debt service amounts. The financing model does not currently incorporate estimates of expenses associated with the ongoing maintenance or capital renewal of either CMS or SAHPC. Given that the financing model projects a sizable FFE balance even after repayment of all debt obligations in 2053, it is unclear to us whether it is only at that point would FFE funds be potentially made available for ongoing maintenance or capital renewal of these or other IA facilities..

- As also noted in the 2013 Haas report, there is non-trivial risk that an earthquake or other catastrophic event may render CMS unusable for a prolonged period which may affect one or more of the revenue streams included in the financing model. We agree with the 2013 report, which in turn refers to a 2010 Academic Senate report, that the campus should consider the impact of a temporary interruption of income streams associated with this possibility and whether risk mitigation measures are warranted, such as the procurement of external business interruption insurance.
- Payments made by seat holders in the ESP are allocated by IA between two FFEs: one which contains funds used to pay for current and future benefits (season ticket, parking, media guide, food, beverages, etc.) provided to seat holders and another which contains the charitable contribution portion of their payment. IA has not completed a long-run projection for annual cash inflows and outflows for the benefits FFE as it has with the contribution FFE. As management has expressed that one of their goals is that the balances are always sufficient in the benefit FFE to pay for annual and future benefits received by ESP seat holders, we believe that a long-term financial model for the benefit FFE would help provide management with a greater understanding of potential outcomes under scenario modeling and stress testing and therefore allowing for more informed decision making. In addition, we observe that the financial model (separate from the CMS/SAHPC financing model) used by IA to calculate the fair market value of benefits received as an ESP seat holder serves two purposes. First it calculates an amount that is provided to the donor so that he/she can subtract it from the full ESP payment amount for charitable deduction reporting for personal income taxes. Second it provides IA with an estimate of the discounted present value of the benefits that should be allocated to the benefits FFE when the annual ESP seat payment is made. These two amounts may be different based upon whether IA uses the estimated cost of providing the benefit to the donor (for example, \$2 for a hot dog paid by IA to the food concessionaire) or the estimate of what the donor would have to pay for that benefit (\$5 for a hot dog at the concession stand at the game) separately. Using the \$5 figure would potentially provide more accurate reporting of the fair market value of the benefit for the donor, but may lead to over-contribution to the benefits FFE as it does not cost IA \$5 to provide the hot dog. Alternatively, using the \$2 figure may provide in the long-run for more accurate contributions to the benefits FFE, but may underreport the fair market value of the benefit received (\$2 rather than \$5). At present, we understand that IA management uses one figure which would potentially result in either over-contribution to the FFE or under reporting fair market value of benefits to the seat holder depending on which figure was used.

Management Response and Action Plan

With regards to the first observation regarding expenses that are related to the revenues earned in the financing model, IA is aware and began reporting expenses to the financial model effective with FY14 including credit card expenses associated with the ESP sales and commissions paid

on the naming rights revenue. Furthermore, effective with FY16, IA will include as part of the financing model compensation expenses that are exclusively or primarily associated with the generation of revenue in the model. This includes the premium sales staff and positions that are primarily directed to generating new revenue in the stadium in the form of sales and leases or supporting the agreement with our naming rights partner. IA will continue to review expenses and apply the accounting matching principal with expenses that are related to revenue reported in the financing model.

While not explicitly stated in the financing model, it is assumed that some of the surpluses projected in the model after 2053 would be applied to any required maintenance or renovations required to CMS and SAHPC forty years after the original construction and renovation.

IA, University Relations, and the campus chief financial officer organization have had recent discussions related to issues involving the calculation of the value of ESP benefits and to determine an action plan to address those issues. As background, around 2009 IA solicited the services of Stadium Capital and Deloitte as part of the development of its ESP sales program. Included in that was a calculation of the benefits provided to donors that included the value of the ticket, hospitality (food and beverage), parking, and certain other miscellaneous benefits. As these seat sales covered periods of between forty and fifty years, the calculation of these benefits made assumptions about inflation and discount rates. As IA begins year four in the new stadium, there are some variances (both positive and negative) between the original assumptions that are currently being used to calculate the amount of the benefit to the donor and also to record as a payable liability. The Berkeley Foundation's external auditor has recommended that we consider a new review of these benefit values.

We agreed that the best time to begin this review would be at the conclusion of this (2015) football season. The last two years have been years of rebuilding for the football program after a coaching change, and, as a result of losing records in the past years, ticket sales have dropped significantly and ESP sales have been below expectations. This has had an impact on the price of a season ticket which is now lower than it was in 2009. The outcome of this football season and its effect on season ticket sales and ESP sales should help drive the direction of these calculations.

We agreed also that it was important that we solicit the services of a third party for this analysis rather than relying on our own analysis. As such, waiting until after the football season allows us some time to find an appropriate third party. Stadium Capital was involved in the original planning of the ESP program although it is not clear to what extent their role was in the development of these benefits calculations. We believe that they may no longer be in business. Deloitte, or another consulting firm, may end up being more appropriate for such an analysis. We believe that our ESP program is unlike any other in college football. While many institutions have seating programs, we are not aware of any that has a seating program involving sales of periods of forty to fifty years. While there are similar programs in professional sports, there is no element of philanthropy or tax deduction in those calculations.

In conclusion, we will begin moving forward to determine what options we do have with regards to third parties for such an analysis. We will move forward then to properly contract their services such that the analysis can commence sometime in early 2016 after the conclusion of the 2015 football season.

Regarding business interruption insurance, we were aware that the campus purchased some business interruption insurance in regards to the stadium but were not very aware of the extent of the coverage. We will investigate what the current policy within the campus covers. The inability to play football in the stadium due to an earthquake or other catastrophic event could have a range of consequences depending on the severity. If scheduling could be resolved by temporarily playing games at another facility such as AT&T Park or the Oakland Coliseum, there would still be additional costs including stadium rental as well as a likely loss of revenue. If the current insurance does not cover the situation, it will be explored. There is also a more severe situation where the team would not play some or all of its games. The consequences of this would be more catastrophic and we will begin by consulting with our colleagues in the Pac-12 to see if anyone has such a policy. The impact on revenue would not only affect the stadium model but the annual operating budget. There is a less catastrophic possibility that a single event might cause the cancellation of one football game that could not be rescheduled. We will also investigate that possibility.