

**THE SAN JOSE CONVENTION CENTER
AND CULTURAL FACILITIES**

Independent Auditor's Report and
Financial Statements

For the Year Ended June 30, 2005

THE SAN JOSE CONVENTION CENTER AND CULTURAL FACILITIES
For the Year Ended June 30, 2005

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City Council
City of San José, California

Independent Auditor's Report

We have audited the accompanying financial statements of the San José Convention Center and Cultural Facilities (the Center), an activity of the City of San José (the City), as of and for the year ended June 30, 2005, as listed in the table of contents. These financial statements are the responsibility of management of the Center. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Center's internal control over reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements of the Center are intended to present the financial position and the changes in financial position and cash flows of only that portion of the City's financial statements that is attributable to the transactions of the Center. The Center is reported within the City's special revenue funds, however, for purposes of this presentation management has elected to report it as an enterprise to comply with contractual requirements. The financial statements of the Center do not purport to, and do not, present fairly the financial position of the City as of June 30, 2005 and the changes in its financial position and its cash flows, where applicable, for the year ended June 30, 2005 in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Center as of June 30, 2005, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

This report is intended solely for the information and use of the City Council and management of the City and is not intended to be and should not be used by anyone other than these specified parties.

Macias, Gini & Company LLP
Certified Public Accountants
Walnut Creek, California

March 30, 2006

The San José Convention Center and Cultural Facilities

Statement of Net Assets

June 30, 2005

Assets:

Current assets:

Cash and investments	\$ 94,499
Accounts receivable, net of allowance	232,975
Accounts receivable - Centerplate	141,009
Other receivables	33,756

Total unrestricted current assets 502,239

Restricted cash and investments 211,367

Total current assets 713,606

Noncurrent assets:

Constuction in progress	54,337
Depreciable capital assets, net	65,251

Total noncurrent assets 119,588

Total assets 833,194

Liabilities:

Current liabilities:

Accounts payable	372,372
Accounts payable - Team San José	31,834
Accrued liabilities	100,239
Accrued liabilities - Convention and Visitor's Bureau	39,100
Deferred revenue	417,130

Total current liabilities 960,675

Net assets (deficit):

Invested in capital assets, net of related deb	80,488
Restricted by the City of San José	211,367
Unrestricted defici	(419,336)
Total net assets (deficit)	\$ (127,481)

See accompanying notes to financial statements.

The San José Convention Center and Cultural Facilities
Statement of Revenues, Expenses and Changes in Net Assets (Deficit)
For the Year Ended June 30, 2005

Operating revenues:	
Building rental	\$ 4,194,140
Food and beverage services	1,209,721
Heat and power service charges	551,427
Event electrical/utility services	460,927
Audio/visual services	266,438
Networking services	245,000
Telecommunications services	99,731
Equipment rentals	56,988
Labor	14,669
Other revenues	59,772
Less City of San José credits for facility usage	<u>(202,379)</u>
Total operating revenues	<u>6,956,434</u>
Operating expenses:	
City of San José management and administrative charges	6,228,160
Utilities	2,321,835
Administrative and general salaries - Team San José	624,235
Other expenses	417,468
Overhead - City of San José	542,368
Contracted outside services	516,980
Contracted services - City of San José	117,403
Operating supplies	302,600
Insurance	276,064
Repairs and maintenance	231,123
Workers' compensation insurance premiums	124,820
Management Fee - Team San José	<u>150,000</u>
Total operating expenses	<u>11,853,056</u>
Operating loss	(4,896,622)
Nonoperating revenues (expenses):	
Contributions from the City of San José	<u>4,769,141</u>
Change in net assets	(127,481)
Net assets (deficit):	
Beginning of year	<u>-</u>
End of year	<u>\$ (127,481)</u>

See accompanying notes to financial statements.

The San José Convention Center and Cultural Facilities

Statement of Cash Flows For the Year Ended June 30, 2005

Cash flows from operating activities:

Receipts from customers and users	\$ 6,965,824
Cash payments to suppliers for goods and services	(5,214,828)
Cash payments to employees for services	<u>(6,127,921)</u>
Net cash used in operating activities	<u>(4,376,925)</u>

Cash flows from non-capital financing activities:

Contributions from the City of San José	<u>4,769,141</u>
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Cash flows from capital and related financing activities:

Purchase of capital assets	<u>(86,350)</u>
Change in cash and cash equivalents	305,866
Cash and cash equivalents, beginning of year	<u>-</u>
Cash and cash equivalents, end of year	<u><u>\$ 305,866</u></u>

Summary of cash and cash equivalents reported on the statement of net assets:

Cash and investments (unrestricted)	\$ 94,499
Restricted cash and investments	<u>211,367</u>
Total cash and cash equivalents reported on the statement of net assets	<u><u>\$ 305,866</u></u>

Reconciliation of operating loss to net cash used in operating activities:

Operating loss	\$ (4,896,622)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Depreciation	5,862
Changes in operating assets and liabilities:	
Accounts receivable	(407,740)
Accounts payable	404,206
Accrued liabilities	100,239
Deferred income	<u>417,130</u>
Net cash used in operating activities:	<u><u>\$ (4,376,925)</u></u>

Noncash capital and related financing activities:

Acquisition of telecommunications and computer software and equipment	\$ 39,100
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See accompanying notes to financial statements.

THE SAN JOSE CONVENTION CENTER AND CULTURAL FACILITIES

Notes to Financial Statements
For the Year Ended June 30, 2005

NOTE 1 – DESCRIPTION OF OPERATIONS

The San José Convention Center and Cultural Facilities (the Center) consists of the San Jose McEnery Convention Center (the main facility), Civic Auditorium, Parkside Hall, Center for the Performing Arts, California Theater (formerly known as the Fox Theater), and Montgomery Theater. The South Hall, an extension of the San Jose McEnery Convention Center, is the newest addition which opened in June 2005. These six venues offer trade show exhibits, conventions, corporate meetings, black tie dinners, consumer shows and performing arts. The City of San José (the City) selected Team San José to manage the operations of the Center (see Note 5). The Team San José management office is located in the east portion of the main facility, which is located at 408 Almaden Boulevard, San José, California.

The Center's financial statements are intended to present the financial position and the changes in financial position and cash flows of only that portion of the City's financial statements that is attributable to the Center's transactions. The Center is reported within the City's special revenue funds, however, for purposes of this presentation management has elected to report it as an enterprise to comply with contractual requirements. The financial statements of the Center do not purport to, and do not, present fairly the financial position of the City as of June 30, 2005 and the changes in its financial position and its cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) *Basis of Presentation and Accounting*

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements, and relates to the timing of measurements made, regardless of the measurement focus applied. The Center is accounted for using the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board (GASB). Governments also have the option of following subsequent private-sector guidance for their enterprise activities, subject to the same limitation. The Center has elected not to apply subsequent private-sector guidance.

(b) *Cash and Cash Equivalents*

All highly liquid investments with original maturities of three months or less are considered to be cash equivalents and are carried at fair value.

(c) *Accounts Receivable*

Accounts receivable consisting of trade and other receivables are recorded at cost. The Center provides for the possible inability to collect accounts by recording an allowance for doubtful accounts. The Center writes off an account when it is considered to be uncollectible. At June 30, 2005, management recorded an allowance of \$101,238.

THE SAN JOSE CONVENTION CENTER AND CULTURAL FACILITIES

Notes to Financial Statements (Continued)

For the Year Ended June 30, 2005

(d) Capital Assets

Capital assets are stated at cost, if purchased or at fair market value on the date received, if donated. Management has established a capitalization threshold of \$5,000 per item with a useful life greater than one year. Depreciation is provided on a straight-line basis over the estimated useful life of each class of depreciable asset. Estimated useful lives are generally five to ten years for furniture and equipment.

(e) Operating Revenues and Expenses

The Center defines its operating revenues as charges for services, which are revenues derived from charges for building rental, audio/visual services, electrical/utility services, equipment rental, catering, concessions, networking services, telecommunication services, and other services. All other revenue not derived from these sources, such as the City's operating subsidies, are classified as nonoperating in the accompanying statement of revenues, expenses and changes in net assets (deficit).

(f) Net Assets (Deficit)

Net assets (deficit) are classified in the following three components:

Invested in Capital Assets, net of related debt consists of capital assets as of June 30, 2005, less amounts owed to the Convention and Visitor's Bureau for the purchase of certain capital assets.

Restricted by the City of San José consists of net assets that are subject to restrictions beyond the Center's control. At June 30, 2005, the Center has \$211,367 in restricted net assets related to the "Receipts Account" maintained by the City.

Unrestricted net assets (deficit) consists of the remaining balance of net assets not subject to the aforementioned categorizations. At June 30, 2005, the Center has an unrestricted deficit balance of \$419,336. The Center is currently unable to meet its operating needs through charges for services and, accordingly, must rely on subsidies from the City to continue operation.

When both restricted and unrestricted resources are available for use, it is the Center's policy to use unrestricted resources first and then restricted resources, as they are needed.

(g) Use of Estimates

The financial statements are prepared in conformity with accounting principles generally accepted in the United States of America, which requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

THE SAN JOSE CONVENTION CENTER AND CULTURAL FACILITIES

Notes to Financial Statements (Continued)

For the Year Ended June 30, 2005

NOTE 3 – CASH AND INVESTMENTS

The Center’s cash and investments consist of the following at June 30, 2005:

Operating account	\$ 94,499
Restricted cash and investments	<u>211,367</u>
Total cash and investments	<u><u>\$ 305,866</u></u>

(a) Restricted Cash and Investments

The Center has adopted the investment policy of the City, which is governed by provisions of the California Government Code and the City’s Municipal Code. According to the investment policy, the City’s cash and investment pool may invest in the State of California Local Agency Investment Fund, obligations of the U.S. Treasury or U.S. Government agencies, time deposits, money market mutual funds invested in U.S. Government securities, along with various other permitted investments.

The Center maintains all of its funds, other than immediate cash needed in the operating account, in the City’s cash and investment pool. It is not possible to disclose relevant information about the Center’s separate portion of the cash and investment pool, as there are no specific investments belonging to the Center itself. Information regarding the characteristics of the entire investment pool can be found in the City’s June 30, 2005 basic financial statements. A copy of that report may be obtained by contacting the City’s Finance Department, 200 East Santa Clara Street, 13th Floor, San José, CA, 95113 or can be found at the City’s Finance Department Web Site at <http://www.csjfinance.org/>. As of June 30, 2005, the Center’s share of the City’s cash and investment pool totaled \$211,367.

(b) Custodial Credit Risk

At year-end, the carrying amount of the Center’s cash deposits was \$94,499 and the bank balance was \$212,467. The difference between the bank balance and the carrying amount represents outstanding checks and deposits in transit. Of the bank balance, \$100,000 was covered by federal depository insurance and \$112,467 was uninsured and uncollateralized. The Center has no policies requiring its depository accounts to be collateralized.

NOTE 4 – CAPITAL ASSETS

The following is a summary of the changes in capital assets for the year ended June 30, 2005:

	<u>Balance</u> <u>July 1, 2004</u>	<u>Additions</u>	<u>Balance</u> <u>June 30, 2005</u>
Nondepreciable capital assets:			
Construction in progress	<u>\$ -</u>	<u>\$ 54,337</u>	<u>\$ 54,337</u>
<i>Depreciable capital assets:</i>			
Computer & Network Equipment	\$ -	\$ 71,113	\$ 71,113
<i>Less accumulated depreciation:</i>			
Computer & Network Equipment	<u>-</u>	<u>(5,862)</u>	<u>(5,862)</u>
Depreciable capital assets, net	<u>\$ -</u>	<u>\$ 65,251</u>	<u>\$ 65,251</u>

THE SAN JOSE CONVENTION CENTER AND CULTURAL FACILITIES

Notes to Financial Statements (Continued)

For the Year Ended June 30, 2005

The current year additions to depreciable capital assets relate to the acquisition of computer equipment, software, network equipment, and the phone system. These assets were acquired at the beginning of the year to support the operation of the Center. Currently, the Center depreciates its network and computer equipment over a five year useful life.

The additions in construction in progress relate to the new accounting software, EBMS, acquired by the Center in December 2004. The EBMS software, owned by Ungerboeck Systems International (USI), is an integrated accounting software package that the Center purchased to merge event sales transactions with accounting operations. EBMS can automatically prepare and process accounting transactions, such as receivables, payables, or general journal entries, through event sales activities recorded in the system by the sales department. EBMS is expected to be completed and placed into service in April 2006, with an estimated total cost of \$200,000.

NOTE 5 – RELATED PARTY TRANSACTIONS

Team San José

Team San José, Inc., a public benefit corporation, was formed in December 2003 in response to the City's request for proposals for the management and operations of the San José Convention Center and Cultural Facilities. Team San José integrates key community stakeholders to create an innovative governance model. The City entered into a Management Agreement (the Agreement) with Team San José to operate and manage the Center. The original term of the Agreement is for the five-year period from July 1, 2004 through June 30, 2009, unless sooner terminated, as provided for in the Agreement. The City has the right to exercise its option to extend the original term for one additional five-year period provided the City meets certain requirements defined in the Agreement.

As compensation for the services rendered by Team San José pursuant to the Agreement, the City pays Team San José a yearly base management fee of \$150,000 and reimburses Team San José's administrative and general salaries. In addition, the Center paid \$21,131 in August 2005 to Team San José employees as performance pay related to service goals met during fiscal year 2004/05.

The San José Convention and Visitors Bureau

The San José Convention and Visitors Bureau (CVB) was established as a nonprofit, 501(c)6 organization in 1984. On June 22, 2004, the City amended and restated the agreement between the City and the CVB to reflect the change in management and operation of the Center from the City's Department of Convention, Arts and Entertainment to Team San José.

The mission of the CVB is to enhance the image and economic well being of San José by taking the leadership role in marketing San José as a globally recognized destination. The CVB provides marketing, promotion and sales support services for the convention center and cultural facilities and provides full service destination planning to meeting planners, tour operators, and individual visitors. The CVB occupies office space at no cost in the San José Convention Center and provides financial and human resource staff to Team San José. At June 30, 2005, the Center owes the CVB \$39,100 for the acquisition of telecommunications and computer software and equipment.

THE SAN JOSE CONVENTION CENTER AND CULTURAL FACILITIES

Notes to Financial Statements (Continued)

For the Year Ended June 30, 2005

A portion of the City's Transient Occupancy Tax (TOT), more commonly referred to as the "hotel tax", supports the operations of the CVB. The TOT is paid by guests of hotels, motels and other similar structures designed for tourist lodging within the San José region. Additionally, the CVB receives supplemental funding through annual partner/advocate fees in which convention hotel partners and tourism advocates (e.g. area restaurants, attractions, shopping, transportation and lodging) contribute.

Centerplate

Centerplate is headquartered in Spartanburg, South Carolina, with customer locations throughout the United States and Canada and provides concessions, merchandise sales, and catering and restaurant services at the Center. Based on the Catering Agreement effective on January 1, 2005, Centerplate will provide catering service to customers of the Center. The Center's portion of revenue collected by Centerplate is paid monthly to the Center, which ranges from 15% to 40% of the gross revenue earned from catering services. During the year, the Center received total food and beverage revenue from Centerplate of \$1,209,721, of which the unpaid balance at June 30, 2005 is \$141,009, and which is reported as a receivable in the statement of net assets.

NOTE 6 – THE CITY OF SAN JOSE SUBSIDIES

In order for the Center to continue its operations, it relies upon the City for subsidies. The operating loss for the year was \$4,896,622 and required operating subsidies from the City, which was received on a cash basis. The City uses a portion of the Transit Occupancy Tax (TOT) and certain revenues collected from parking garages to fund these subsidies. Accordingly, any significant changes in the TOT or parking garage revenues or decision to change the amount of support could greatly affect the Center's ability to continue as a going concern.

NOTE 7 – CLAIMS AND LITIGATION

The Center is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; and natural disasters. The Center funds the costs of salaries and benefits, including the cost of workers' compensation premiums for Team San José employees. Team San José is required to purchase commercial insurance, as specified in the Management Agreement. The coverage provided by commercial insurance and excess coverage as of June 30, 2005 are as follow:

<u>Provider</u>	<u>Type of Coverage</u>	<u>Coverage Amount</u>
The Hartford	Commercial Package	\$ 1,000,000
Stephen Chelbay Co.	Director & Officers Liability	1,000,000
Filice P&C Insurance	Commercial General Liability	1,000,000
	Liquor Liability	1,000,000
	Excess/Umbrella Liability	4,000,000
	Crime Section	500,000

Certain claims, suits and complaints arising in the ordinary course of business have been filed or are pending against the Center. In the opinion of management, such claims if disposed of unfavorably, would not have a material adverse effect on the financial position or changes in financial position of the Center and are considered in the City's loss reserves.