



# Memorandum

**TO:** PUBLIC SAFETY, FINANCE &  
STRATEGIC SUPPORT COMMITTEE

**FROM:** Scott P. Johnson  
Steven Hendrickson

**SUBJECT:** SEE BELOW

**DATE:** November 1, 2007

Approved

*Ray Wener*

Date

*11/8/07*

**COUNCIL DISTRICT:** City-wide

**SUBJECT: INDEPENDENT AUDITOR'S REPORT AND FINANCIAL STATEMENTS  
OF THE SAN JOSE CONVENTION CENTER AND CULTURAL FACILITIES FOR  
THE YEAR ENDED JUNE 30, 2007**

## RECOMENDATION

Accept the San José Convention Center and Cultural Facilities Independent Auditor's Report and Financial Statements for the fiscal year ended June 30, 2007 issued by Macias Gini & O'Connell, LLP, as presented to the Public Safety, Finance & Strategic Support Committee.

## BACKGROUND

On June 22, 2004, the City Council approved an Agreement for the management of the San José Convention Center and Cultural Facilities (Facilities) between the City of San José and Team San Jose, Inc. (Management Agreement) for a five-year period beginning July 1, 2004. The Management Agreement requires that at the end of each contract year, an audit of the books and records of the Facilities shall be performed by the City's independent certified public accountants (External Auditors) at the Facility's expense.

On December 6, 2005, the City Council adopted resolution No. 72998 which authorized the City Auditor to negotiate and execute an amendment to the General City Agreement with Macias Gini & O'Connell, LLP (MGO). The amendment added the performance of annual financial audits of the Facilities under the management of Team San Jose, Inc. for fiscal years 2004-05 through 2006-07, and two one-year extension options for fiscal years ended June 30, 2008 and 2009.

November 1, 2007

**Subject: Independent Auditor's Report and Financial Statements of the San José Convention Center**

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### **ANALYSIS**

MGO audited the financial statements of the Facilities for the fiscal year ended June 30, 2007 in accordance with auditing standards generally accepted in the United States of America. MGO issued the opinion that the financial statements presented fairly, in all material respects, the financial position of the Facilities in conformity with accounting principles generally accepted in the United States of America. (See attached report).

### **COORDINATION**

This memorandum has been coordinated with the City Manager's Office.

### **CEQA**

Not a project.

  
SCOTT P. JOHNSON  
Director, Finance Department

  
STEVEN HENDRICKSON  
Interim City Auditor

Attachment

**SAN JOSÉ CONVENTION  
AND CULTURAL FACILITIES**  
(An Activity of the City of San José)

Independent Auditor's Report and  
Financial Statements

For the Year Ended June 30, 2007

**SAN JOSÉ CONVENTION AND CULTURAL FACILITIES**  
(An Activity of the City of San José)  
For the Year Ended June 30, 2007

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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 and Cultural Facilities (the Center), an activity of the City of San José (the City), as of and for the year ended June 30, 2007, 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, 2007 and the changes in its financial position and its cash flows, where applicable, for the year ended June 30, 2007 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, 2007, 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 & Cannelo LLP*  
Certified Public Accountants  
Walnut Creek, California

October 30, 2007

# SAN JOSE CONVENTION CENTER AND CULTURAL FACILITIES

(An Activity of the City of San José)

Statement of Net Assets

June 30, 2007

## Assets:

### Current assets:

Cash in bank	\$ 1,584,018
Accounts receivable, net of allowance	590,154
Accounts receivable - Centerplate	285,314
Other receivables	246,909
Prepaid expenses	39,221

Total current assets 2,745,616

### Noncurrent assets:

Construction in progress	122,040
Depreciable capital assets, net	1,968,008

Total noncurrent assets 2,090,048

Total assets 4,835,664

## Liabilities:

### Current liabilities:

Accounts payable	479,619
Accounts payable - Team San José	54,600
Accrued liabilities	352,867
Unearned revenue	692,751

Total current liabilities 1,579,837

## Net assets:

Invested in capital assets	2,090,048
Unrestricted	1,165,779

Total net assets \$ 3,255,827

See accompanying notes to financial statements.

## SAN JOSE CONVENTION CENTER AND CULTURAL FACILITIES

(An Activity of the City of San José)

Statement of Revenues, Expenses and Changes in Net Assets

For the Year Ended June 30, 2007

### Operating revenues:

Building rental	\$ 5,078,075
Food and beverage services	2,521,900
Event electrical/utility services	737,676
Heat and power service charges	771,870
Networking services	482,964
Audio/visual services	431,674
Other revenues	294,046
Telecommunications services	117,310
Equipment rentals	59,977
Labor	59,070
Less City of San José credits for facility usage	(193,045)
Less City of San José credits for power charges	(239,912)
Total operating revenues	<u>10,121,605</u>

### Operating expenses:

City of San José management and administrative charges	6,645,397
Utilities	2,535,946
Administrative and general salaries - Team San José	1,237,668
Contracted outside services	461,066
Other expenses	763,447
Overhead - City of San José	865,262
Operating supplies	420,768
Repairs and maintenance	394,565
Insurance	449,516
Workers' compensation insurance premiums	130,268
City of San José oversight	214,393
Management Fee - Team San José	150,000
Depreciation	239,308
Total operating expenses	<u>14,507,604</u>
Operating loss	(4,385,999)

### Nonoperating revenues:

Contributions from Centerplate	30,000
Contributions from special revenue funds of the City of San José	<u>6,313,785</u>
Change in net assets	1,957,786

### Net assets:

Beginning of year	<u>1,298,041</u>
End of year	<u>\$ 3,255,827</u>

See accompanying notes to financial statements.

**SAN JOSE CONVENTION CENTER AND CULTURAL FACILITIES**

(An Activity of the City of San José)

Statement of Cash Flows

For the Year Ended June 30, 2007

Cash flows from operating activities:	
Cash receipts from customers	\$ 9,554,389
Cash payments to suppliers for goods and services	(13,119,964)
Cash payments to employees for services	<u>163,199</u>
Net cash provided by operating activities	<u>(3,402,376)</u>
Cash flows from noncapital financing activities:	
Contributions from Centerplate	30,000
Contributions from special revenue funds of the City of San José	<u>4,825,508</u>
Net cash provided by noncapital financing activities	<u>4,855,508</u>
Cash flows from capital and related financing activities:	
Purchase of capital assets	<u>(744,403)</u>
Change in cash in bank	708,729
Cash in bank, beginning of year	<u>875,289</u>
Cash in bank, end of year	<u>\$ 1,584,018</u>
Reconciliation of operating loss to net cash provided by operating activities:	
Operating loss	\$ (4,385,999)
Adjustments to reconcile operating loss to net cash provided by operating activities:	
Depreciation	239,308
Goods and services paid by the City of San José	1,488,277
Changes in assets and liabilities:	
Accounts receivable	(276,251)
Other receivables	(156,554)
Prepaid expenses	(34,172)
Accounts and other payables	(305,773)
Accrued liabilities	163,199
Unearned revenue	<u>(134,411)</u>
Net cash provided by operating activities	<u>\$ (3,402,376)</u>

See accompanying notes to financial statements.

## SAN JOSÉ CONVENTION AND CULTURAL FACILITIES

(An Activity of the City of San José)

Notes to Financial Statements

For the Year Ended June 30, 2007

### NOTE 1 - DESCRIPTION OF OPERATIONS

The San José Convention and Cultural Facilities (the Center) consists of the San José McEnergy 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 José McEnergy 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. Unlike enterprise funds, special revenue funds do not report capital assets and related depreciation; these items are only reported in the government-wide financial statements of the City. 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, 2007 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*

The accounts receivable balance at June 30, 2007 is reported net of an allowance for estimated uncollectible amounts. Management has estimated the uncollectible amounts to be \$197,924.

## SAN JOSE CONVENTION AND CULTURAL FACILITIES

(An Activity of the City of San José)

Notes to Financial Statements (Continued)

For the Year Ended June 30, 2007

### (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 fixtures, machinery and equipment, and leasehold improvements.

### (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.

### (f) *Net Assets*

Net assets are classified in the following two components:

*Invested in Capital Assets* consists of the Center's capital assets net of related accumulated depreciation. All debt related to the acquisition of capital assets have been repaid as of June 30, 2007.

*Unrestricted net assets* consist of the remaining balance of net assets not subject to the aforementioned categorization. At June 30, 2007, the Center has an unrestricted balance of \$1,165,779.

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.

**SAN JOSE CONVENTION AND CULTURAL FACILITIES**

(An Activity of the City of San José)

Notes to Financial Statements (Continued)

For the Year Ended June 30, 2007

**NOTE 3 – CASH IN BANK**

The Center's cash in bank consists of the following at June 30, 2007:

Operating account	\$ 42,133
Payroll account	55,128
Receipts account	<u>1,486,757</u>
Total cash in bank	<u>\$ 1,584,018</u>

**(a) Nature of bank accounts**

The Center maintains all of its funds as cash deposits. The operating account is in the name of Team San José and is used to disburse funds for operations or for capital outlays under the direction of Team San José. The receipts account is in the name of the City of San José and is under the custodianship of the City. All revenues collected by the Center are deposited into the receipts account and the City disburses funds from the receipts account to the operating account and payroll account as demands are made by Team San José to facilitate operations.

**(b) Custodial Credit Risk**

At year-end, the carrying amount of the Center's operating account was \$42,133 and the bank balance was \$199,442. The difference between the bank balance and the carrying amount represents outstanding checks and deposits in transit. There was no difference between the carrying amount and the bank balance for the payroll account balance of \$55,128. Of the combined bank balance, \$100,000 was covered by federal depository insurance and \$154,570 was uninsured and uncollateralized.

At year-end, the carrying amount of the Center's receipts account was \$1,486,757 and the bank balance was \$1,481,957. The difference between the bank balance and the carrying amount represents a deposit in transit. The amounts placed on deposit with the bank were covered by federal depository insurance or were collateralized by the pledging financial institutions as required by Section 53652 of the California Government Code. Such collateral is held by the pledging financial institutions' trust department or agent in the Center's name.

**SAN JOSE CONVENTION AND CULTURAL FACILITIES**  
(An Activity of the City of San José)  
Notes to Financial Statements (Continued)  
For the Year Ended June 30, 2007

**NOTE 4 – CAPITAL ASSETS**

The following is a summary of the changes in capital assets for the year ended June 30, 2007:

	Balance June 30, 2006	Additions	Transfers	Balance June 30, 2007
<i>Nondepreciable capital assets:</i>				
Construction in progress	\$ 726,315	\$ 202,363	\$ (806,638)	\$ 122,040
<i>Depreciable capital assets:</i>				
Computer and network equipment	\$ 71,113	\$ 9,422	\$ 193,636	\$ 274,171
Machinery and equipment	73,102	28,645	-	101,747
Furniture and fixtures	-	33,356	4,027	37,383
Leasehold improvements	744,815	470,617	608,975	1,824,407
Total depreciable capital assets	889,030	542,040	806,638	2,237,708
<i>Less accumulated depreciation:</i>				
Computer and network equipment	(11,544)	(94,767)	-	(106,311)
Machinery and equipment	(8,088)	(32,400)	-	(40,488)
Furniture and fixtures	-	(1,870)	-	(1,870)
Leasehold improvements	(10,760)	(110,271)	-	(121,031)
Total accumulated depreciation	(30,392)	(239,308)	-	(269,700)
Depreciable capital assets, net	\$ 858,638	\$ 302,732	\$ 806,638	\$ 1,968,008

The current year transfers to depreciable capital assets relate primarily to the completion of several projects including the digital sign, the co-generation restoration project, and the EBMS software package. The digital sign is displayed in front of the Center's entrance area to display upcoming events and the total project cost \$476,000. The co-generation restoration project is to enhance the performance of the generator to produce electricity and chilled water. The chilled water is supplied to the adjacent buildings and the total project cost is \$136,000. 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. Portions of the EBMS software have been capitalized as modules have been put into service. The remaining modules for sales and event services were completed during the year and costs totaling \$194,000 were transferred.

The ending balance in construction in progress at June 30, 2007 consists primarily of a building assessment project, an electrical substation project and a fire attenuation system. The building assessment project is to determine the amount of deferred maintenance needed for the Center's facilities in order to maintain them in operating condition. The electrical substation project is to perform repairs on the substation that will extend the life of the unit and reduce electrical costs. The fire attenuation system project will replace the broken communication system. Costs incurred during the fiscal year related to these projects totaled \$81,000. Additional smaller amounts make up the remaining balance of items added to construction in progress during the fiscal year.

## SAN JOSE CONVENTION AND CULTURAL FACILITIES

(An Activity of the City of San José)  
Notes to Financial Statements (Continued)  
For the Year Ended June 30, 2007

### NOTE 5 - SIGNIFICANT AGREEMENTS WITH OUTSIDE PARTIES

#### 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 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 \$39,212 in August 2007 to Team San José employees as performance pay related to service goals met during fiscal year 2007.

#### 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.

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, 2006, 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 \$2,435,930, of which the unpaid balance at June 30, 2007 is \$285,314, and which is reported as a receivable in the statement of net assets.

## SAN JOSE CONVENTION AND CULTURAL FACILITIES

(An Activity of the City of San José)  
Notes to Financial Statements (Continued)  
For the Year Ended June 30, 2007

### NOTE 6 – THE CITY OF SAN JOSE CONTRIBUTIONS FROM SPECIAL REVENUE FUNDS

In order for the Center to continue its operations, it relies upon the City for contributions. The operating loss for the year was \$4,385,999 and required operating contributions from the City, which were received on a cash basis. The City also contributed \$1,050,239 towards current year capital expenditures and \$877,547 towards cash reserves for a total subsidy of \$6,313,785. The City uses a portion of the Transit Occupancy Tax (TOT) from the Transit Occupancy Tax Fund, a special revenue fund, and certain revenues collected from parking garages from the General Purpose Parking Fund, a special revenue fund, 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, 2007 is as follow:

<u>Provider</u>	<u>Type of Coverage</u>	<u>Coverage Amount</u>
The Hartford	Automobile	\$ 1,000,000
AIG	Director & Officers Liability	1,000,000
	Crime - Employee Dishonesty	500,000
State Fund	Workers' Compensation	1,000,000
Liberty Surplus Insurance	General Liability	2,000,000
Liberty Insurance Underwriters	Excess/Umbrella Liability	4,000,000
RSUI Landmark American Insurance	Miscellaneous Professional Liability	2,000,000
Travelers Bond	ERISA Bond	10,000

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.