



Memorandum

TO: Honorable Mayor and City Council

FROM: Sharon W. Erickson,
City Auditor

SUBJECT: *Follow-up Review Of Arena
Management Agreement*

DATE: June 9, 2008

Background

In 1991, the City and San José Arena Management entered into a Management Agreement to operate San José Arena, now known as the HP Pavilion at San Jose. The Management Agreement defines fee and revenue payments to the City, outlines the treatment of County possessory interest tax payments, and identifies reports Arena Management must submit to the City.

In March 2002, the City Auditor's Office issued *An Audit of the San José Arena Management Corporation's Compliance with the San José Arena Management Agreement*. The audit identified issues with Arena fee payment calculations, compliance with reporting requirements, and underpayment for possessory interest tax deductions.

Objectives, Scope, And Methodology

In accordance with the City Auditor's 2007-08 Workplan, we conducted a follow-up review of components to the Arena Management Agreement. Our objective was to review Possessory Interest Tax and Arena Fee calculations and determine compliance with specific Management Agreement reporting requirements. We reviewed audit documentation, interviewed City and Arena Authority staff, and reviewed pertinent sections of the Arena Management Agreement.

We performed our review in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objectives.

Results

Possessory Interest Tax

The San José Arena Management Agreement between the City of San José and San José Arena Management allows Arena Management to deduct certain possessory interest property taxes from the Arena fees it pays to the City. A separate agreement between the Redevelopment Agency and the City requires the Agency to reimburse the City for possessory interest tax deductions that Arena Management deducts from its payment to the City. With the assistance of the City Auditor's Office, the City recovered \$650,254 for 2005 and 2006.

Fee Payments

The Management Agreement requires Arena Management to pay the City Arena-related fees and payments on an annual basis. Preliminary review revealed that Arena Management underpaid fees related to Gross Ticket revenue and Luxury Suite revenue for 2005-06 and 2006-07. As a result of our review, Arena Management paid \$12,904 in additional fee payments.

Reporting Requirements

The City Auditor's March 2002 audit report found that Arena Management, the Arena Authority, and City Attorney's Office should develop a mutually agreeable delivery schedule regarding the frequency of the detailed reports and records relating to the City Related Accounts. Additionally, the March 2002 report recommended Arena Management provide the past and future City Income Reports and Audit Reports in accordance with the Management Agreement.

In August 2007, the City signed the second amendment to the Arena Management Agreement, which included amended language that allows for a delivery schedule determined by the City for reports and records to the City Related Accounts. The Second Amendment included a requirement that Arena Management engage a Certified Public Accounting firm to conduct an agreed upon procedures engagement reviewing Arena Management annual financial statements for the City Related Accounts (City Income Reports).

Arena Management provided to the City required City Income Reports and Audit Reports. Further, Arena Management engaged KPMG to perform the agreed upon procedures engagement as provided for under the Second Amendment to the Arena Management Agreement. KPMG completed the engagements through 2005-06. According to the Arena Authority, KPMG has preliminarily completed the review for 2006-07, which is expected to be delivered by Arena Management to the City shortly.

Conclusion

In 2007, the City collected \$663,158 from Arena Management and the Redevelopment Agency. We would like to thank Arena Management, the Arena Authority, the City Manager's Office and the Redevelopment Agency for their assistance.



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