

**SAN JOSE 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, 2009

SAN JOSE CONVENTION AND CULTURAL FACILITIES
(An Activity of the City of San José)
For the Year Ended June 30, 2009

Table of Contents

	<i>Page(s)</i>
Independent Auditor's Report	1 - 2
Financial Statements:	
Statement of Net Assets	3
Statement of Revenues, Expenses and Changes in Net Assets	4
Statement of Cash Flows.....	5
Notes to Financial Statements	6 - 12



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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, 2009, 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, 2009 and the changes in its financial position and its cash flows, where applicable, for the year ended June 30, 2009 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, 2009, and the changes in its financial position and its cash flows for the year then ended in conformity with the basis of presentation and accounting described in Note 1.

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 & Connell LLP
Certified Public Accountants
Walnut Creek, California

November 19, 2009

SAN JOSE CONVENTION CENTER AND CULTURAL FACILITIES

(An Activity of the City of San José)

Statement of Net Assets

June 30, 2009

Assets:

Current assets:

Cash and cash equivalents	\$ 1,652,144
Accounts receivable, net of allowance	1,186,747
Accounts receivable - Centerplate	126,067
Other receivables	104,046
Inventories	94,172
Prepaid expenses	34,022
Other assets	5,000

Total current assets 3,202,198

Capital assets:

Construction in progress	162,119
Depreciable capital assets, net	1,719,818

Total capital assets 1,881,937

Total assets 5,084,135

Liabilities:

Current liabilities:

Accounts payable	907,841
Accounts payable - Team San José	25,000
Accrued liabilities	513,768
Unearned revenue	1,512,871

Total current liabilities 2,959,480

Net assets:

Invested in capital assets	1,881,937
Unrestricted	242,718

Total net assets \$ 2,124,655

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, 2009

Operating revenues:

Building rental	\$ 5,281,338
Food and beverage services	2,008,242
Event electrical/utility services	695,084
Heat and power service charges	580,649
Networking services	380,334
Audio/visual services	446,967
Other revenues	364,404
Ticketing services	123,865
Telecommunications services	80,465
Equipment rentals	58,159
Event production labor revenues	2,331,468
Less City of San José credits for facility usage	(184,138)
Less City of San José credits for power charges	(319,756)
Total operating revenues	<u>11,847,081</u>

Operating expenses:

City of San José management and administrative charges	6,662,719
Utilities	2,561,984
Administrative and general salaries - Team San José	1,923,319
Cost of event production labor	1,967,629
Overhead - City of San José	883,727
Other expenses	645,780
Bad debt expense	567,751
Contracted outside services	535,234
Professional services	509,676
Operating supplies	469,809
Depreciation	362,113
Repairs and maintenance	299,702
Insurance	257,948
City of San José oversight	220,774
Workers' compensation insurance premiums	219,996
Fire insurance	200,000
Management fee - Team San José	150,000
Equipment rentals	117,100
Repairs and maintenance - City Funded	48,479

Total operating expenses 18,603,740

Operating loss (6,756,659)

Nonoperating revenues:

Contributions from City of San José funds 6,262,771

Change in net assets (493,888)

Net assets:

Beginning of year 2,618,543

End of year \$ 2,124,655

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, 2009

Cash flows from operating activities:	
Cash receipts from customers	\$ 12,308,256
Cash payments to suppliers for goods and services	(6,858,461)
Cash payments to employees for services	<u>(10,692,008)</u>
Net cash used in operating activities	<u>(5,242,213)</u>
Cash flows from noncapital financing activities:	
Contributions from the City of San José	<u>6,262,771</u>
Cash flows from capital and related financing activities:	
Purchase of capital assets	<u>(133,538)</u>
Change in cash and cash equivalents	887,020
Cash and cash equivalents, beginning of year	<u>765,124</u>
Cash and cash equivalents, end of year	<u><u>\$ 1,652,144</u></u>
Reconciliation of operating loss to net cash used in operating activities:	
Operating loss	\$ (6,756,659)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Depreciation	362,113
Changes in assets and liabilities:	
Accounts receivable	361,457
Other receivables	(55,970)
Inventories	(94,172)
Prepaid expenses	(14,994)
Other assets	(5,000)
Accounts and other payables	375,914
Accrued liabilities	(138,341)
Unearned revenue	<u>723,439</u>
Net cash used in operating activities	<u><u>\$ (5,242,213)</u></u>

See accompanying notes to financial statements

SAN JOSE CONVENTION AND CULTURAL FACILITIES

(An Activity of the City of San José)

Notes to Financial Statements

For the Year Ended June 30, 2009

NOTE 1 – DESCRIPTION OF OPERATIONS

The San José Convention and Cultural Facilities (the Center) consists of the San José 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. 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 fund 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, 2009 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, 2009 is reported net of an allowance for estimated uncollectible amounts. Management has estimated the uncollectible amounts to be \$868,599.

SAN JOSE CONVENTION AND CULTURAL FACILITIES

(An Activity of the City of San José)

Notes to Financial Statements

For the Year Ended June 30, 2009

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(d) Inventories

Inventories consist of food and beverage supplies that are stated at the lower of cost (first in, first-out method) or market.

(e) 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 assets. Estimated useful lives are generally five to ten years for computer and network equipment, furniture and fixtures, machinery and equipment, and leasehold improvements.

(f) 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.

(g) Net Assets

Net assets are classified in the following two components:

Invested in Capital Assets consist of the Center's capital assets net of related accumulated depreciation.

Unrestricted net assets consist of the remaining balance of net assets not subject to the aforementioned categorization.

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.

(h) 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

For the Year Ended June 30, 2009

NOTE 3 – CASH AND CASH EQUIVALENTS

The Center’s cash and cash equivalents consists of the following at June 30, 2009:

Payroll account	\$ 17,392
Receipts account	1,621,886
Petty cash	300
Cash on hand	12,566
	<hr/>
Total cash and cash equivalents	<u>\$ 1,652,144</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 (\$57), which is reported as part of accounts payable, and the bank balance was \$66,434. The difference between the bank balance and the carrying amount represents outstanding checks and deposits in transit. The carrying amount of the Center’s payroll account was \$17,392 and the bank balance was \$20,173. Of the combined bank balance, \$86,607 was covered by federal depository insurance.

At year-end, the carrying amount of the Center’s receipts account was \$1,621,886 and the bank balance was \$1,623,523. The difference between the bank balance and the carrying amount represents outstanding checks. 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 City’s name.

SAN JOSE CONVENTION AND CULTURAL FACILITIES

(An Activity of the City of San José)

Notes to Financial Statements

For the Year Ended June 30, 2009

NOTE 4 – CAPITAL ASSETS

The following is a summary of the changes in capital assets for the year ended June 30, 2009:

	Balance June 30, 2008	Additions	Balance June 30, 2009
<i>Nondepreciable capital assets:</i>			
Construction in progress	\$ 147,833	\$ 14,286	\$ 162,119
<i>Depreciable capital assets:</i>			
Computer and network equipment	\$ 278,990	\$ 12,628	\$ 291,618
Machinery and equipment	322,528	34,965	357,493
Furniture and fixtures	56,433	37,379	93,812
Leasehold improvements	<u>1,883,264</u>	<u>34,280</u>	<u>1,917,544</u>
Total depreciable capital assets	<u>2,541,215</u>	<u>119,252</u>	<u>2,660,467</u>
<i>Less accumulated depreciation:</i>			
Computer and network equipment	(188,002)	(87,349)	(275,351)
Machinery and equipment	(71,506)	(55,584)	(127,090)
Furniture and fixtures	(12,522)	(15,647)	(28,169)
Leasehold improvements	<u>(306,506)</u>	<u>(203,533)</u>	<u>(510,039)</u>
Total accumulated depreciation	<u>(578,536)</u>	<u>(362,113)</u>	<u>(940,649)</u>
Depreciable capital assets, net	<u>\$ 1,962,679</u>	<u>\$ (242,861)</u>	<u>\$ 1,719,818</u>

Additions to depreciable asset categories totaled \$119,252 for the year ending June 30, 2009 and consisted of the following:

1. Purchase of software for \$4,628 – This software upgrade was implemented in January 2009 to automate the import of accounts receivable purchase orders and other data.
2. Purchase of SJ TIX assets for \$8,000 – The Center took over the SJ TIX portion of the business when the prior operator went bankrupt. Various equipment including computers and ticketing machines were purchased from SJ TIX in May 2009.
3. Replacement of batteries and inverter control board for the Meyers System totaling \$34,964 – This purchase was to replace the batteries for the emergency backup power system and inoperable lighting control boards at the Center for Performing Arts.
4. Purchase of Virco tables and chairs for \$37,380 – Tables and chairs were purchased in November 2008 to replace the City’s furniture no longer usable due to normal wear and tear.
5. Replacement of ballroom lighting transformer for \$20,880 – The ballroom lighting transformer was replaced in stages because the old transformer was failing, causing vibrations and overheating.
6. Plumbing upgrade on the Civic Auditorium for \$13,400 – Piping rework was done in March 2009 on certain areas of the plumbing system, including sleeve inserts, thereby increasing the life of the plumbing system.

Additions to the Construction In Progress account at June 30, 2009 consist of an electrical substation project. The electrical substation project is to perform repairs on the substation that will extend the life of the unit and reduce electrical costs. Costs incurred during the fiscal year related to this project totaled \$14,286.

SAN JOSE CONVENTION AND CULTURAL FACILITIES

(An Activity of the City of San José)

Notes to Financial Statements

For the Year Ended June 30, 2009

NOTE 4 – CAPITAL ASSETS (Continued)

The ending balance in the Construction In Progress account at June 30, 2009 consisted of the following:

1. Fire attenuation system design totaling \$12,000 - This project has been put on hold, as it may be incorporated into the Convention Center expansion project.
2. Electrical substation project totaling \$108,871 - The last phase of this project has been delayed until October 2009. The Center begins depreciation upon completion of the project.
3. Event Business Management Software (EBMS) conversion totaling \$41,248 - This represents the costs incurred while the Center prepared activities such as the accounting module data establishments, proper resource master set up, general ledger account set up, and system training. While the research and exploration on the accounting module continue, the Center has not actively switched its accounting operation to EBMS even though the Sales and Event Management modules were fully converted and have been utilized since fiscal year 2007. The Center tested out more of its features and went live on the accounting module during September 2009.

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 Center. 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. On August 13, 2009, the City exercised its option to extend the original term for one additional five-year period through June 30, 2014.

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 \$142,053, as part of Administrative and General Salaries – Team San José, to Team San José employees as performance pay related to service goals met during fiscal year 2009. At June 30, 2009, the Center has an unpaid accrued liability balance of \$83,206 to Team San José employees.

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 the City by taking the leadership role in marketing the City 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.

SAN JOSE CONVENTION AND CULTURAL FACILITIES

(An Activity of the City of San José)

Notes to Financial Statements

For the Year Ended June 30, 2009

NOTE 5 – SIGNIFICANT AGREEMENTS WITH OUTSIDE PARTIES (Continued)

The Center receives 3% of the City's 10% Transient Occupancy Tax (TOT), more commonly referred to as the "hotel tax", that 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 provides 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 \$1,616,797, of which the unpaid balance at June 30, 2009 is \$126,067, which is reported as a receivable in the statement of net assets. Effective June 24, 2009, the Center terminated its relationship with Centerplate and started to provide food and beverage services to its customers directly.

TSJ Events, LLC

On March 19, 2009, Team San José established TSJ Events, LLC, in the State of California to provide food and beverages at events catered by the Center. Team San José is the only member of TSJ Events, LLC, and, as such, has a controlling interest in the operations of the entity. The General Manager of Team San José has been designated as the manager of TSJ Events, LLC. Per the Operating Agreement between Team San José and TSJ Events, LLC, all revenues and expenses from activities performed by TSJ Events, LLC will be allocated to Team San José. As of June 30, 2009, the Center paid legal services totaling \$12,705 on behalf of TSJ Events, LLC.

NOTE 6 – CONTRIBUTIONS FROM CITY OF SAN JOSE FUNDS

In order for the Center to continue its operations, it relies on the City for operating contributions. The operating loss for the year was \$6,756,659 which required an operating cash contribution in the amount of \$6,262,771 from the City. The City uses a portion of TOT from its Transient Occupancy Tax Special Revenue Fund and certain revenues collected from parking garages from its Parking System Enterprise Fund to fund this contribution. 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.

SAN JOSE CONVENTION AND CULTURAL FACILITIES

(An Activity of the City of San José)

Notes to Financial Statements

For the Year Ended June 30, 2009

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, 2009 is as follows:

<u>Provider</u>	<u>Type of Coverage</u>	<u>Coverage Amount</u>
Property & Casualty Insurance	Automobile	\$ 1,000,000
National Union Fire Insurance	Director & Officers Liability	1,000,000
National Union Fire Insurance	Crime - Employee Dishonesty	1,000,000
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

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.