

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

Public Safety, Finance &
Strategic Support Committee

Fiscal Year Ended
June 30, 2009

SAN JOSE CONVENTION AND CULTURAL FACILITIES

Public Safety, Finance & Strategic Support Committee
Fiscal Year Ended June 30, 2009

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SACRAMENTO

OAKLAND

LOS ANGELES

NEWPORT BEACH

SAN DIEGO

Members of the Public Safety, Finance &
Strategic Support Committee
and San José City Council
City of San José, California

In planning and performing our audit of the 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, in accordance with auditing standards generally accepted in the United States of America, we considered the Center's internal controls over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing our opinion on the effectiveness of the Center's internal control. Accordingly, we do not express an opinion on the effectiveness of the Center's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified a deficiency in internal control that we consider to be a material weakness.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the Center's financial statements will not be prevented, or detected and corrected on a timely basis. We consider Item #2009-A in the Schedule of Comments and Responses to be a material weakness.

The Center's written response to the findings identified in our audit is described in the Schedule of Comments and Responses. We did not audit the Center's responses and, accordingly, we express no opinion on them. In addition, we have already discussed our comments and recommendations with various Center personnel and the City's management, and we would be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing these recommendations.

Additionally, we have included in this letter a report on communications with the Public Safety, Finance & Strategic Support Committee (Committee) as required by auditing standards generally accepted in the United States of America.

This communication is intended solely for the information and use of management, the Committee, City Council, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

MACIAS GINI & O'CONNELL LLP

Macias Gini & O'Connell LLP
Certified Public Accountants

Walnut Creek, California
November 19, 2009

SAN JOSE CONVENTION AND CULTURAL FACILITIES
Required Communications and Recommendations
For the Year Ended June 30, 2009

REQUIRED COMMUNICATIONS

We have audited the 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 and have issued our report thereon dated November 19, 2009. Professional auditing standards require that we communicate to you the following information related to our audit.

I. The Auditor's Responsibility Under U.S. Generally Accepted Auditing Standards

As stated in our Engagement Communication section of our General Audit Plan dated June 12, 2009, our responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your responsibilities. Our responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement.

As part of our audit, we considered the Center's internal control. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

II. Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you in our audit plan dated June 12, 2009.

III. Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Center are described in Note 2 to the Center's financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ended June 30, 2009. We noted no transactions entered into by the Center during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

SAN JOSE CONVENTION AND CULTURAL FACILITIES
Required Communications and Recommendations
For the Year Ended June 30, 2009

REQUIRED COMMUNICATIONS (Continued)

The most sensitive estimates affecting the financial statements were:

- Estimated allowance for losses on accounts receivable and
- Depreciation estimates for capital assets, including depreciation methods and useful lives assigned to depreciable property.

Management's judgments and estimates were based on the following:

- Estimated allowances for losses on accounts receivable were based on industry averages and
- Useful lives for depreciable property were determined by management based on the nature of the capital assets.

We evaluated the key factors and assumptions used to develop the accounting estimates described above in determining that they are reasonable in relation to the Center's financial statements taken as a whole.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated November 19, 2009.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the Center's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Center's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

SAN JOSE CONVENTION AND CULTURAL FACILITIES
Required Communications and Recommendations
For the Year Ended June 30, 2009

SCHEDULE OF COMMENTS AND RESPONSES

Item # 2009-A – Material Weakness #1

Lack of Sufficient Controls Over Certain Year-End Financial Reporting Processes

During our audit, we observed that the Center does not have sufficient internal controls over year-end financial reporting processes, which led us to identify the following audit adjustments:

- The Center overstated accounts receivable and deferred revenues in the amount of \$73,155.
Accounts receivable and deferred revenues were overstated by \$73,155 because the Center records the full contract amount for an event upon its completion into accounts receivable and revenues and does not eliminate the deferred revenue until completion of the invoice. Several contract events that were completed prior to June 30, 2009 were not invoiced prior to June 30, 2009. Since contract events require an advance deposit that is recorded as deferred revenue upon receipt, events that occur but are not billed prior to June 30, 2009 overstate accounts receivable and deferred revenues.
- The Center overstated its receipts cash account and accounts payable account in the amount \$235,491.
The Center used its cash disbursement process to transfer customer revenues totaling \$235,491 from the operating account to the receipts account. As of June 30, 2009, the Center recorded the transfer between accounts but did not prepare the check to actually transfer the funds. The amount is recorded as part of the accounts payable balance at June 30, 2009. Since the transaction represents a transfer between Center bank accounts and not a payable to an outside vendor, we reversed this transaction to eliminate the overstatement to accounts payable.
- The Center understated payroll expense and accrued liabilities in the amount of \$53,940.
The Center records City payroll expenses on a cash basis rather than on an accrual basis. The City pays its employees on a bi-weekly schedule, which often results in earned wages not being paid at year-end. Since the Center has numerous City employees, it needs to accrue wages payable and associated City payroll expenses as part of its year-end close process. City employees earned \$53,940 for the three days in June of the 14-day pay period that ended in July 2009.

We recommend that the Center establish internal controls over year-end financial reporting, such that all balances and transactions are properly supported and analyzed before the financial statements are submitted for audit. Implementation of these key controls over financial reporting would reduce the risk of deficiencies in reporting, such as those noted above.

Management Response

The Center has reviewed its internal controls over year-end financial reporting and has established the following processes:

- The Center has implemented procedures to ensure the proper recording of accounts receivable and deferred revenue. On a quarterly basis, the Center will perform a reconciliation of accounts receivable and deferred revenue balances to ensure that they are properly stated.

SAN JOSE CONVENTION AND CULTURAL FACILITIES
Required Communications and Recommendations
For the Year Ended June 30, 2009

SCHEDULE OF COMMENTS AND RESPONSES (Continued)

- The cash receipt of \$235,491 was inadvertently deposited into the wrong cash account. The accounting system in the Center is set-up in a way that transfers and reclassifications between the Center's cash accounts require setting-up an account payable. In the future, the Center will ensure that customer receipts are deposited and posted in the correct account and transfers of funds if any, between accounts are done properly and in a timely manner.
- The Center will ensure that the accrual for payroll is reconciled with the City in order to properly record payroll expenses.

Item # 2009-B – Deficiency in Internal Control #1
Inadequate Supporting Documentation and Inconsistent Approval Over Journal Entries

During our tests of controls over the Center's journal entry process, we identified the following deficiencies:

- 2 journal entries were not approved;
- 2 journal entries were approved subsequent to recording into the general ledger; and
- 5 journal entries where the sequence of approval and recording could not be validated.

We recommend that the Center only approve journal entries with documentation included to sufficiently support the transactions' amounts and descriptions.

Management Response

The Center's written policy for Journal Entries requires that all journal entries are approved prior to posting into the general ledger system. The management at the Center feels that the controls in the journal entry approval process are adequate. The Center will continue to implement these controls and will test the policy on an annual basis to ensure that they are being followed.

SAN JOSE CONVENTION AND CULTURAL FACILITIES
Required Communications and Recommendations
For the Year Ended June 30, 2009

STATUS OF PRIOR YEAR RECOMMENDATIONS

2007-B Comment: **Reconciliation of Detailed Schedules to the General Ledger**
2008-A Comment: **Lack of Sufficient Controls Over Certain Year-End Financial Reporting Processes**

The Center did not reconcile its detailed supporting schedules for bank accounts and deferred revenues to the general ledger. We recommend that the Center designate a qualified individual to review these schedules to ensure that they reconcile prior to the beginning of the audit.

Status: Partially implemented. See comment 2009-A.

2007-F Comment: **Developing a Disaster Recovery Plan**

The Center does not have a well-defined, written disaster recovery plan. We recommend that the City require management to develop a disaster recovery plan to better plan for future emergencies.

Status: Partially implemented. The Center has a disaster recovery plan but it does not address contingency plans for re-establishing the financial system in case of a disaster.

2008-B Comment: **Timely Collection of Advance Deposits**

The Center does not consistently record advance deposits to offset the receivables recorded in the Accounts Receivable Aging Report. We recommend that the Center develop a formal advance deposit collection policy to minimize the amount of revenues that become delinquent and uncollectible.

Status: Implemented

2008-C Comment: **Inadequate Segregation of Duties Over Cash Receipts and Financial Reporting**

The Center lacks appropriate segregation of duties over the cash receipts and financial reporting transaction streams. We recommend that the Center segregate the key duties in each of these transaction streams.

Status: Implemented