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

Report to the City Council

For the Year Ended
June 30, 2011

MGO Certified Public Accountants.

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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, 2011, 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 such deficiencies have been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

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 did not identify any deficiencies in internal control that we consider to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency in internal control described as Item #2011-A in the accompanying schedule of comment and response to be a significant deficiency.

The Center's written response to the significant deficiency identified in our audit has not been subjected to the audit procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Additionally, we have included in this letter a report on communications with the City Council as required by auditing standards generally accepted in the United States of America.

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This communication is intended solely for the information and use of management, 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

Walnut Creek, California
October 21, 2011

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, 2011 and have issued our report thereon dated October 21, 2011. 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

Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards as well as certain information related to the planned scope and timing of our audit. We have previously communicated such information in our Engagement Communication section of our General Audit Plan dated June 30, 2011.

II. 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, 2011. 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.

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 historical write-off rates and industry averages and
- Useful lives for depreciable property were determined by management based on the nature of the capital assets and the straight-line method of depreciation was applied.

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.

REQUIRED COMMUNICATIONS (Continued)

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosure affecting the financial statements was use of the enterprise fund presentation on the Center's operations. As more fully described in Note 1 to the financial statements, 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 to comply with contractual requirements.

Difficulties Encountered in Performing the Audit

We encountered some difficulties attaining information on a timely basis to stay within the parameters set forth during the entrance meeting.

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 other than those that are trivial. The following significant misstatements detected as a result of audit procedures were corrected by management:

- Transfers to and from the City in the aggregate of $531,000, were recorded as a reduction to cash, even though the transaction was dated mid-July 2011; and
- Annual fees of $50,000 for annual data center and support services paid after year-end were incorrectly accrued as accounts payable and prepaid expenses.

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 October 21, 2011.

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.

SCHEDULE OF COMMENT AND RESPONSE

Item # 2011-A – Significant Deficiency
Controls Over Certain Year-End Financial Reporting Processes

During our audit of various financial statement areas, 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 unearned revenue in the amount of $16,718. Due to the Center's accounts receivable system limitations, the accounts receivable balance was not removed when an event was cancelled.

- The Center incorrectly accrued accounts payable and prepaid expenses in the amount of $50,000.

- The Center and the City did not reconcile City contributions in a timely manner.

We recommend that the Center establish internal controls over year-end financial reporting, such that balances and transactions associated with automatic system processes are properly reviewed and reconciled to the General Ledger to ensure the financial statements are accurately presented in accordance with generally accepted accounting principles.

We also recommend the City and the Center work together to ensure that the City contributions are reconciled between the City's records and the Center's records in a timely manner. Any adjustments associated with this reconciliation should be recorded prior to the start of the year-end financial statement audit.

Management Response

Team San Jose will work to further strengthen the year-end close process as well as make modifications to the existing standard operating procedures.

- The current billing system is not automated to account for a partial refund of an initial deposit due to an event cancellation. To ensure that accounts receivable and unearned revenues are not overstated, Team San Jose will develop a manual accounting process to identify events where a partial deposit has been refunded and an accounting transaction needs to be entered to reduce accounts receivable and unearned revenue accordingly.

- To ensure invoices received for future services are accounted for in the proper period, Team San Jose has revised year-end accounting procedures to include a review of all vendor invoices received in the month of June.

- To ensure a timely year-end reconciliation of City contributions, Team San Jose and the City will reconcile contributions on a quarterly basis.

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STATUS OF PRIOR YEAR RECOMMENDATIONS

2010-A Comment:

Lack of Written Policies and Procedures
The Center lacked written policies and procedures in operational areas over a number of transaction streams. The Center did not have sufficient internal controls over year-end financial reporting processes. We recommend that the Center implement comprehensive written policies and procedures over all significant transaction streams. In addition, the Center should consider developing a training plan in coordination with the City so that all employees who are responsible for financial transactions receive regular training over topics such as budget monitoring and the proper recording of revenues and expenses.

Status: Implemented.

2010-B Comment:

Net Assets Account Postings
The Center did not reconcile the prior year's ending net assets accounts to the current year's beginning net assets accounts. In addition, the Center made direct adjustments amounting to $52,842 to its net assets accounts to record current year activity. This principle is known as the "clean surplus" theory of equity. As a result, the Center did not record all of the current year's activity in its operating statement. However, it should be noted that during the audit, these adjustments to the net asset accounts were corrected and the activity properly reflected in the FY 2009-2010 audited financial statements.

Status: Implemented

STATUS OF PRIOR YEAR RECOMMENDATIONS (Continued)

2010-C Comment:

Proper Recording and Capitalization of Transactions
While reviewing capital asset disclosures and performing substantive analytic procedures over expenses, we identified maintenance costs of $61,000 that were improperly capitalized and renovation costs in the amount of $117,178 that were improperly expensed. As such, the maintenance costs should have been expensed and the renovation costs should have been capitalized. Misclassification of such transactions misstates the assets and operating expenses of the Center. We recommend that the Center implement a year-end procedure to evaluate the composition of the transactions capitalized in capital asset accounts and expensed in repairs and maintenance. Any misclassifications of transactions within these categories should be reclassified to ensure that assets and operating expenses are properly stated. In addition, the Center should start budgeting capital outlay for planned capital expenditures so that all expected cash outflows are accounted for as part of the budget.

Status: Implemented.

2010-D Comment:

Reconciliation of City Contributions with Center Bank Statements
The Center recorded numerous adjustments to reclassify and record transactions to reconcile the City contributions to the City's records after the start of the audit period. One of these adjustments was a $465,000 transaction to transfer funds from the Center's operating account to a City bank account. We recommend the City and the Center work together to ensure City contributions are reconciled between the City's records and the Center's records in a timely manner. Any adjustments associated with reconciliation should be recorded prior to the start of the year-end financial statement audit.

Status: Partially implemented, see #2011-A.

2009-A Comment:

Lack of Sufficient Controls Over Certain Year-End Financial Reporting Processes
The Center did not have sufficient internal controls over year-end financial reporting processes. 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.

Status: Partially implemented, see #2011-A.

STATUS OF PRIOR YEAR RECOMMENDATIONS (Continued)

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 and emergency manual but it does not address contingency plans for re-establishing the financial system in case of disaster.