



September 29, 2017

City Council
City of San José, California

Grant Thornton LLP
10 Almaden Boulevard, Suite 800
San Jose, CA 95113
T 408.275.9000
F 408.275.0582
www.GrantThornton.com

Ladies and Gentlemen:

In connection with our audit of San José Convention and Cultural Facilities (the “Center”), an activity of the City of San José (the “City”), financial statements as of June 30, 2017 and for the year then ended, auditing standards generally accepted in the United States of America (“US GAAS”) require that we communicate the following information related to our audit to management and the City Council.

Responsibilities

Our responsibilities

We are responsible for:

- Performing an audit under US GAAS of the financial statements prepared by Team San José management, with City oversight
- Forming and expressing an opinion about whether the financial statements are presented fairly, in all material respects in accordance with an accrual basis of accounting
- Forming and expressing an opinion about whether certain supplementary information is fairly stated in relation to the financial statements as a whole
- Reading other information and considering whether it is materially inconsistent with the financial statements
- Communicating specific matters to you

An audit provides reasonable, not absolute, assurance that the financial statements do not contain material misstatements due to fraud or error. It does not relieve you or management of your responsibilities. Our respective responsibilities are described further in our engagement letter.

Those Charged with Governance and Management Responsibilities

Those charged with governance (City Council) are responsible for:

- Overseeing the financial reporting process
- Setting a positive tone at the top and challenging the City's activities in the financial arena
- Discussing significant accounting and internal control matters with management
- Informing us about fraud or suspected fraud, including its views about fraud risks
- Informing us about other matters that are relevant to our audit, such as:
 - Entity strategies and related business risks that may result in heightened risks of material misstatement
 - Matters warranting particular audit attention
 - Significant communications with regulators
 - Matters related to the effectiveness of internal control and your oversight responsibilities
 - Your views regarding our current communications and your actions regarding previous communications

Management is responsible for:

- Defining the reporting entity (the Center)
- Preparing and fairly presenting the financial statements in accordance with US GAAP
- Designing, implementing, evaluating, and maintaining effective internal control over financial reporting
- Communicating significant accounting and internal control matters to those charged with governance
- Providing us with unrestricted access to all persons and all information relevant to our audit
- Informing us about fraud, illegal acts, significant deficiencies, and material weaknesses
- Adjusting the financial statements, including disclosures, to correct material misstatements
- Informing us of subsequent events
- Providing us with certain written representations
- Monitoring compliance with the Management Agreement between the City and Team San José

Audit Scope and Results

Materiality

Materiality is the magnitude of an omission or misstatement that likely influences a reasonable person's judgment. It is based on a relevant financial statement benchmark. We believe that total revenues is the appropriate benchmark for the Center. Financial statement items greater than materiality are in scope. Other accounts or classes of transactions less than materiality may be in scope if qualitative factors are present (for example, related party relationships or transactions and fraud risk).

Significant risks and other focus areas

Based on our risk assessments, we identified Revenues and Related Party Transactions as two significant areas of focus. To address the risk in revenue, we performed detailed revenue analytics and selected testing as well as analysis of the Center's allowance for doubtful accounts. We sampled the accounts receivable detail at year-end and tested invoices via confirmation, subsequent receipts, and alternative procedures. To address the risk in related party transactions, we reviewed the Agreement for the Management of the San José Convention Center and Cultural Facilities and the Agreement for Convention & Visitors Bureau Services between the City of San José and Team San José to ensure proper contractual accounting treatment. Additionally, we performed detail testing over the contributions from the City and Transient Occupancy Tax contributions.

Recorded misstatements

Refer to Appendix A for Schedule of recorded adjustments identified during the audit.

Quality of accounting practices and alternative treatments

Accounting policies

Accounting policies appear to be consistency and appropriately applied. The significant accounting policies are disclosed in the financial statements, including certain disclosures about the enterprise (accrual) fund accounting framework applied as prescribed by the Governmental Accounting Standards Board.

Accounting estimates

We believe that the allowance for doubtful accounts receivable is a particularly sensitive accounting estimate. We are satisfied as to the reasonableness of management's current judgment regarding this estimate in the context of the financial statements taken as a whole, based on our knowledge of management's process for making such judgment, inquiry of management and others regarding such matters, and other audit procedures applied during the engagement.

Internal control matters

A deficiency in internal control ("control deficiency") 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 a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the company's financial statements will not be prevented, or detected and corrected, on a timely basis. 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 responsible for oversight of the company's financial reporting.

Our responsibilities related to internal control consist of the following:

- Obtain reasonable assurance about whether the financial statements are free of material misstatement
- Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Center's internal control
- We express no opinion on the effectiveness of internal control
- Control deficiencies that are of a lesser magnitude than a significant deficiency were communicated to management.

Our consideration of internal control was not designed to identify all deficiencies in internal control that, individually or in combination, might be significant deficiencies. Therefore, significant deficiencies may exist that were not identified. However, we consider the following identified control deficiencies to be significant deficiencies.

Segregation of Duties

Team San José's Chief Financial Officer has administrative access to the Center's financial reporting system, including the ability to create, edit, post, and approve journal entries, which is incompatible with their duties. There are no compensating controls present at the Center that cannot be overridden as the system's audit log can be deleted and the employee is ultimately responsible for the statement of net position reconciliations and financial statements. This increases the risk that changes are made to the financial reporting system or journal entries are recorded without review, and errors are not detected.

Recommendations

To mitigate this risk, we recommend that the users with administrative rights be limited to only those who require them to perform their duties. Additionally, we recommend that the duties of senior financial reporting personnel be limited to review and authorization of journal entries, or additional procedures be implemented to provide for the review of journal entries prepared and posted by the senior financial reporting personnel. The Center should have adequate staffing that would ensure segregation of duties and facilitate proper review of journal entry posting.

Management's Response (unaudited)

Management has implemented this recommendation. However, we believe that Team San Jose has strong compensating controls to prevent any misstatement of financial information. In all reasonable circumstances, the controls would be sufficient.

Timeliness of Accounting Estimate Input Identification

During the course of our audit, we noticed that the Center had reversed an erroneous over-accrual of a workers compensation liability carried forward from FY16 for \$419,589. This misstatement originated in FY16 when details of an insurance quote were misinterpreted, resulting in the exclusion of a discount factor in the year-end workers compensation liability calculation. The calculation was corrected in FY17 when the final invoice was received with an out-of-period credit to worker's compensation expense. Although the entry did not materially misstate FY16 or FY17 and was related to an estimate, all relevant inputs should have been identified timely through the year-end close process or the monitoring thereof.

Recommendations

We recommend Center management strengthen controls around the development and review of estimates to ensure that the calculations, including available inputs and assumptions are reviewed for completeness and accuracy.

Management's Response (unaudited)

During FY17, management implemented a new process to minimize the risk of a significant variance in all estimates and strengthened the review process to further reduce such risk.

The City's written response to the internal control matters identified herein have not been subjected to our audit procedures and, accordingly, we express no opinion on it.

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This communication is intended solely for the information and use of management and the City Council of the City of San José and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

GRANT THORNTON LLP

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Appendix A – Schedule of adjustments

Recorded adjustments

1	Accounts Receivable - Team San Jose	\$	229,190				
	Accounts Receivable		(229,190)				
	<i>To reclass related party receivables for financial statement presentation purposes</i>						
2	Accounts Receivable		180,778				
	Accounts Payable	\$		180,778			
	<i>To reclass customer net credit balances in AR to payables</i>						
3	Accounts Receivable - Team San Jose		159,826				
	Accounts Payable			159,826			
	<i>To reclass net debit balances in AP to TSJ receivables</i>						
4	Accounts Receivable		141,030				
	Accounts Payable			141,030			
	<i>To reclass net debit payable balances to receivables</i>						
	Net impact	\$	481,634	\$	481,634	\$	-
						\$	-

Unrecorded adjustments

	Miscellaneous Expense			\$	419,589		
	Retained Earnings			\$	419,589		
	<i>To reverse the credit to miscellaneous expense booked to correct the overaccrual of workers compensation in FY16</i>						
	Net impact	\$	-	\$	-	\$	419,589
						\$	419,589