

City Council
City of San José, California

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Ladies and Gentlemen:

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In connection with our audit of the San José Convention and Cultural Facilities (the Center), an activity of the City of San José (the City), financial statements as of June 30, 2016 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
- 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):

- 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:
 - Objectives and strategies and related business risks that may result in material misstatement
 - Matters warranting particular audit attention
 - Significant communications with regulators
 - Matters related to the effectiveness of internal control and your related oversight responsibilities
 - Your views regarding our current communications and your actions regarding previous communications

Management:

- Defining the reporting entity (the Center)
- Preparing and fairly presenting the financial statements in accordance with 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

Essentially, 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 areas 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 are consistency and appropriately applied. The significant accounting policies are disclosed in the financial statements. We suggested and the Center and the City agreed to certain disclosures about the Center and the accounting to be consistent with the enterprise (accrual) fund accounting framework 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 charged with governance.

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.

Significant Deficiency

During the course of our audit, adjustments were identified and quantified, with the help of Team San José management, related to: (1) the reclassification of net credit customer receivable balances, (2) the under accrual of the vacation accrual resulting from a new union agreement, and (3) the need to present, gross, certain accounts payable and prepaid expense balances to vendors that were netted as amounts due to/from the City.

In the case of the vacation accrual, management was investigating a potential adjustment, however, this was not communicated as a pending adjustment to the audit team during fieldwork and was not identified and posted timely.

Although these entries did not aggregate to a material error, these errors should have been identified timely through the year-end close process or the monitoring thereof.

Recommendations

Accurate and timely financial statements of the Center are important because the City includes the financial activities of the Center in the City’s Comprehensive Annual Financial Report. The City outsources management and accounting for the Center to Team San José. Team San José, with the City’s oversight, is responsible for timeliness of and quality of financial reporting.

Accounting tasks such as monthly reconciliations, cross-checks, and reviews play a key role in proving the accuracy of accounting data and financial information that comprise year-end financial statements. While these errors were corrected and reflected in the financial statements, we suggest that Center management strengthen controls around the timeliness of their review of account reconciliations, communicate items that are not final at the start of the audit, and implement procedures to track the gross amounts of vendor payables and prepaid expenses (referred to, internally, as pass through accounts to the City) to facilitate accurate financial statement presentation.

Management's Response (unaudited)

The Center management will re-assess the timing of the year-end audit to ensure that the review of account reconciliations can be completed before the start of the audit. The status of the account reconciliation will be communicated to the auditors at the beginning of the year-end audit work.

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

The logo consists of the words "Grant Thornton LLP" written in a stylized, cursive font.

October 20, 2016
San José, California

Appendix A – Schedule of adjustments

Description	Increase (Decrease) to:			Change in Net Position
	Assets	Liabilities	Net Position	
<u>Recorded adjustments</u>				
1 AR Trade	205,111			
Accounts Payable		(205,111)		
<i>To reclass net credit balances in AR</i>				
2 Vacation Expense			(359,966)	(359,966)
Accrued Wages - Vacation		359,966		
<i>To adjust for underaccrued vacation</i>				
3 Pass Thru City (City of SJ AP)		(400,187)		
TOT Transfer			400,187	400,187
<i>To adjust TOT receivable for adjustments</i>				
4 Contributions from City of SJ				(6,414,611)
City Funded Repairs & Maintenance				6,414,611
<i>To eliminate gross up of activity inconsistent with the GASB enterprise framework of accounting</i>				
5 Accounts payable - City of San José		6,805		
Prepaid expenses - event related	78,994			
Accounts payable - event related		72,189		
Contracted Outside Services			63,194	63,194
Operating supplies			4,675	4,675
Repairs and maintenance			2,715	2,715
Equipment rentals			52,611	52,611
Other expenses			11,606	11,606
Contributions from Transient Occupancy Tax Fund			(134,801)	(134,801)
<i>To break out pass through AR and AP which was presented net</i>				
Total impact	\$ 284,105	\$ (166,338)	\$ 40,221	\$ 40,221