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, 2008

SAN JOSE CONVENTION AND CULTURAL FACILITIES

Public Safety, Finance & Strategic Support Committee
Fiscal Year Ended June 30, 2008

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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, 2008, 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 would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

A 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies as listed as items 2008-A and 2008-B to be significant deficiencies in the Center's internal control. In addition, we noted other matters involving the internal control and its operation that we have reported to management as listed in the table of contents.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. However, we believe that none of the deficiencies listed as items 2008-A and 2008-B constitute material weaknesses.

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 3, 2008

SAN JOSE CONVENTION AND CULTURAL FACILITIES
Required Communications and Recommendations
For the Year Ended June 30, 2008

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, 2008 and have issued our report thereon dated November 3, 2008. Professional auditing standards require auditors to communicate with the audit committee, or its equivalent, on a number of subjects.

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

As stated in our Engagement Communication section of our General Audit Plan dated June 19, 2008, 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.

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.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Center's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

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 19, 2008.

III. Accounting Policies

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, 2008. We noted no transactions entered into by the Center during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

IV. Accounting Estimates

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
- 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
- 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.

V. Audit Adjustments

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. The following material misstatement detected as a result of audit procedures were corrected by management:

- Adjustments for recording wire transfers from the Center to the City for payment of payroll expenses and recording repairs and maintenance expenses funded by the City were identified and proposed.

VI. Management Representations

We have requested certain representations from management that are included in the management representation letter dated November 3, 2008.

VII. 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.

VIII. 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.

IX. 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.

X. Difficulties Encountered in Performing the Audit

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

SCHEDULE OF COMMENTS AND RESPONSES

Item # 2008-A – Significant Deficiency #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 deficiencies:

- Detailed schedules completed by the Center did not reconcile to the general ledger at the time of the audit . The schedules included bank and deferred revenues account reconciliations.
- The Center does not have a process in place to group and track capital asset purchases by construction projects. This makes it difficult to determine whether an individual transaction is part of a larger project or an expense that falls below the Center's capitalization threshold.
- The Center's accounts receivable aging schedule included credit or negative balances due to rental credits owed but not paid to customers. The Center provides rental revenue credits to customers who purchase a certain level of services from the Center and reimburses them the credit upon payment in full of the invoice. In order to not understate the Center's liability balance, these credit balances should be identified and recorded as a liability at year-end.

Deficiencies in financial reporting such as the ones summarized above could be the product of a) a failure to implement internal controls as designed or b) a lack of key internal controls. During our process of understanding and documenting the Center's internal controls, we noted that the Center does not have an internal control process over year-end financial reporting that provides documented evidence that key controls exist.

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. We also recommend that the Center obtain a disclosure checklist for governmental financial reporting, to ensure that all new accounting principles that are relevant to the Center are considered during the financial statement review. 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 will implement processes and procedures to address the internal control issues regarding year-end financial reporting to ensure that all balances and transactions are properly supported and analyzed prior to submitting the financial statements for audit.

Item # 2008-B – Significant Deficiency #2
Timely Collection of Advance Deposits

As part of our audit, we selected events that have not occurred as of the balance sheet date and test whether advance deposits collected against these events have been properly recorded. We selected a sample of ten transactions to test and noted that the Center applied the concept of revenue recognition correctly to these transactions. In order to test the accuracy of these ten transactions, we requested a copy of the deposit and verified that it was consistent with the terms of the contract. When we requested these deposits, the Center was unable to provide two of the deposits from our sample of ten transactions, specifically AOPA Expo 2008 and Adobe Worldwide Sales Conference, because the customers had not paid the deposits in accordance with the terms of the contract.

The revenue manager is responsible for ensuring that an advance deposit is collected in accordance with the contract. Advance deposits are required in order to commit the customer to follow through on their contractual commitment to hold the event and pay for its associated costs. Advance deposits also guarantee collection of a percentage of revenues, as they require the customers to advance pay a significant portion of the fees for services prior to the provision of those services. By not collecting these advance deposits in accordance with contractual terms, the Center allows these amounts to become receivables, which subjects them to the risk of becoming delinquent and uncollectible accounts. This can lead to lost revenues and higher costs of operations as more resources must be committed to receivable collections.

We recommend that the Center develop a formal advance deposit collection policy to minimize the amount of revenues that become delinquent and uncollectible. As part of this policy, the Center should designate a position that has the authority to enforce the policy and sanction noncompliance.

Management Response:
The Center recognizes the importance of collecting advance deposits to help ensure that revenue is collected and does not become delinquent or uncollectible. The Center will formalize the advance deposit collection policy and ensure that the policy contains a designated individual with sufficient authority to enforce the policy.

Item # 2008-C – Control Deficiency #1
Inadequate Segregation of Duties over Cash Receipts and Financial Reporting

During our audit, we noted a lack of segregation of duties for the cash receipts transaction stream. We identified that the person in charge of preparing the deposit slip and making the deposit is also in charge of receivables collection and recording payments against customer receivable balances. A lack of segregation of duties in this area increases the risk that customer payments will be misappropriated rather than applied against customer receivable balances.

In addition, during our internal control documentation, we noted a lack of segregation of duties for the financial reporting transaction stream. We noted that one of the people who is in charge of recording journal entries also performs bank reconciliations. A lack of segregation of duties in this area increases the risk that fraudulent activity can be disguised in reconciling items in the bank reconciliations.

We recommend that the Center segregate the duties of preparing the deposit from making the deposit in order to minimize the risk of misappropriation of assets. These duties should also be segregated from other key cash receipts functions such as receiving and opening the mail that includes customer payments.

In addition, we recommend that the Center segregate the duties of recording journal entries from reconciling bank statements within the financial reporting process to minimize the risk of misappropriation of assets. These duties should also be segregated from other key financial reporting functions such as initiating and approving journal entries, as well as the ability to modify the chart of accounts.

Management Response:
The Center understands the importance of segregation of duties over cash receipts and financial reporting, and has implemented procedures to segregate such duties, including the receipt and opening of mail, preparing and making deposits, and recording cash receipts to MAS 90, as well as duties between recording journal entries and reconciling bank statements within the financial reporting process. Working within the constraints of limited resources in the department, the Center believes that this segregation of duties over cash receipts and financial reporting adequately protects the Center’s assets.

SAN JOSE CONVENTION AND CULTURAL FACILITIES
Required Communications and Recommendations
For the Year Ended June 30, 2008

STATUS OF PRIOR YEAR RECOMMENDATIONS

2007-A Comment: **Reconciliation of the City Subsidy**

The Center did not properly record or reconcile the City operating subsidy. We recommend that the Center record subsidy transactions in operating accounts and perform monthly reconciliations to agree to the City's records.

Status: Implemented

2007-B Comment: **Reconciliation of Detailed Schedules to the General Ledger**

The Center did not reconcile its detailed supporting schedules for capital assets 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: Capital asset detailed schedules were reconciled but other schedules were not, see Item #2008-A above

2007-C Comment: **Calculation of Allowance for Doubtful Accounts**

The Center uses a direct write-off method for identifying and recording bad debt. We recommend that the Center estimate an allowance for bad debt based on a percentage of sales or outstanding receivables.

Status: Implemented

2007-D Comment: **Journal Entry Process**

Journal entries do not consistently have supporting documentation or approval signatures prior to posting. We recommend that the Center follow its formal procedures for recording journal entries to minimize the risk of misstatement.

Status: Implemented

2007-E Comment: **Application of Discounts**

The Center provides discounts to customers who purchase a minimum level of service. We recommend that the Center record these discounts in building revenues rather than other income.

Status: Implemented

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: Not implemented, the Center is working on a written disaster recovery plan with a goal of implementing it in fiscal year 2009.