

San Diego Convention Center Corporation
(a component unit of the
City of San Diego, California)

Annual Financial Report

For the Year Ended June 30, 2014

San Diego Convention Center Corporation
Annual Financial Report
For the Year Ended June 30, 2014

TABLE OF CONTENTS

	<u>Page</u>
Independent Auditor's Report	1
Management's Discussion and Analysis (Required Supplementary Information - Unaudited)	3
Basic Financial Statements	
Statement of Net Position	10
Statement of Revenues, Expenses and Changes in Net Position	11
Statement of Cash Flows	12
Notes to the Basic Financial Statements.....	14
Other Report	
Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	22

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
San Diego Convention Center Corporation
City of San Diego, California

Report on the Financial Statements

We have audited the accompanying financial statements of the San Diego Convention Center Corporation (SDCCC), a component unit of City of San Diego, California, as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise SDCCC's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of SDCCC, as of June 30, 2014, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3-9 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 28, 2014, on our consideration of SDCCC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering SDCCC's internal control over financial reporting and compliance.

A handwritten signature in black ink that reads "Macias Gini & O'Connell LLP". The signature is written in a cursive, flowing style.

San Diego, California
October 28, 2014

MANAGEMENT'S DISCUSSION AND ANALYSIS

THIS PAGE LEFT BLANK INTENTIONALLY

San Diego Convention Center Corporation
Management's Discussion and Analysis
For the Year Ended June 30, 2014
(Unaudited)

As management of the San Diego Convention Center Corporation (SDCCC), we offer readers of SDCCC's financial statements this narrative overview and analysis of the financial activities of SDCCC for the year ended June 30, 2014. We encourage readers to consider the information presented here in conjunction with additional information that has been furnished.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as the introduction to SDCCC's basic financial statements. The financial statements of SDCCC report information about SDCCC using accounting methods similar to those used by private-sector companies. These statements offer short-term and long-term financial information about its activities.

The Statement of Net Position presents information of all SDCCC's assets, deferred outflows of resources, liabilities, and deferred inflows of resources as of June 30, 2014. The difference between (a) assets and deferred outflows of resources and (b) liabilities and deferred inflows of resources is reported as net position. Over time, increases and decreases in net position may serve as a useful indicator of whether the financial position of SDCCC is improving or deteriorating. SDCCC did not have any deferred outflows or deferred inflows of resources as of June 30, 2014.

The Statement of Revenues, Expenses and Changes in Net Position presents information showing changes in SDCCC's net position during the most recent fiscal year. All changes in net position are reported when the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., earned but unused paid time off).

The Statement of Cash Flows presents information showing cash receipts and cash payments during the fiscal year, a reconciliation of operating income to net cash provided by operating activities as well as detail of noncash investing, capital and financing activities.

San Diego Convention Center Corporation
Management's Discussion and Analysis (Continued)
For the Year Ended June 30, 2014
(Unaudited)

SDCCC FINANCIAL STATEMENT ANALYSIS

The following is a summary of SDCCC's assets, liabilities and net position comparing FY 2014 with FY 2013.

	<u>FY 2014</u>	<u>FY 2013</u>	Percentage Increase (Decrease)
ASSETS:			
Cash and deposits	\$ 8,328,917	\$ 8,213,265	3%
Receivables	5,302,770	4,650,616	14%
Prepaid expenses	639,198	602,708	6%
Deposits with others	139,334	-	
Capital assets, net	<u>29,952,554</u>	<u>29,669,563</u>	1%
Total assets	<u>44,362,773</u>	<u>43,136,152</u>	3%
LIABILITIES:			
Accounts payable	570,994	685,788	(17%)
Accrued liabilities	3,636,996	3,357,184	8%
Unearned income	8,488,671	8,168,280	4%
Current portion of long-term debt	12,629,266	220,030	5,640%
Long-term portion of accrued liabilities	27,523	231,398	(88%)
Long-term debt	<u>17,029</u>	<u>15,646,296</u>	(100%)
Total liabilities	<u>25,370,479</u>	<u>28,308,976</u>	(10%)
NET POSITION:			
Net investment in capital assets	17,306,259	15,535,965	11%
Unrestricted	<u>1,686,035</u>	<u>(708,789)</u>	
Total Net Position	<u>\$ 18,992,294</u>	<u>\$ 14,827,176</u>	28%

Assets

Total Assets of \$44.4 million at FY 2014 year end increased by \$1.3 million, or 3%, from the prior year end balance of \$43.1 million. All asset categories moderately increased compared to last year, with the largest increase in receivables of \$0.7 million, or 14%. The increase in receivables was most significantly impacted by food and beverage and utility commissions invoiced at FY 2014 year end related to the 2014 Bio International Conference event hosted in June 2014 that were paid for in July 2014.

San Diego Convention Center Corporation
Management's Discussion and Analysis (Continued)
For the Year Ended June 30, 2014
(Unaudited)

SDCCC FINANCIAL STATEMENT ANALYSIS (Continued)

Liabilities

Total Liabilities of \$25.4 million at FY 2014 year end decreased by \$2.9 million, or 10%, from a balance of \$28.3 million in FY 2013 due primarily to the elimination of a long-term debt obligation. The long-term debt balance decrease of \$15.6 million, or 100%, was primarily the result of loan forgiveness on a \$3.0 million note payable related to the Phase III expansion project which was determined to be a non-enforceable obligation by the California Department of Finance and to a \$12.5 million land lease note payable due in May 2015 that was reclassified to a current liability with no impact to overall total Liabilities.

Net Position

Total net position of \$19.0 million at FY 2014 year end increased by \$4.2 million, or 28%, compared to the prior year balance of \$14.8 million. Unrestricted net position increased by \$2.4 million compared to the prior year due to excess of revenues over expenses of \$4.2 million, including the \$3.0 million extraordinary item related to the long-term debt forgiveness. Combined FY 2014 capital expenses and debt forgiveness that funded prior existing Phase III expansion capitalized expenses exceeding depreciation expense during FY 2014 partially offset the increase in unrestricted net position. Net investment in capital assets increased by \$1.8 million compared to the prior year due to FY 2014 capital purchases and capitalized expenses combined with Phase III expansion debt forgiveness exceeding depreciation expense during FY 2014.

San Diego Convention Center Corporation
Management's Discussion and Analysis (Continued)
For the Year Ended June 30, 2014
(Unaudited)

SDCCC FINANCIAL STATEMENT ANALYSIS (Continued)

The following table summarizes the changes in net position for SDCCC comparing FY 2014 with FY 2013.

	<u>FY 2014</u>	<u>FY 2013</u>	<u>Percentage Increase (Decrease)</u>
Operating Revenues:			
Rental	\$ 8,989,948	\$ 8,738,560	3%
Food and beverage	8,430,578	7,172,846	18%
Ancillary services	11,673,384	10,807,343	8%
Contributions from the City of San Diego	3,405,000	3,405,000	-
Other revenue	<u>40,392</u>	<u>31,913</u>	27%
Total operating revenues	<u>32,539,302</u>	<u>30,155,662</u>	8%
Operating Expenses:			
Salaries and benefits	19,844,875	19,066,030	4%
Services and supplies	8,086,254	8,397,136	(4%)
Depreciation	1,935,649	2,087,009	(7%)
Marketing contract	<u>1,900,000</u>	<u>1,900,000</u>	-
Total operating expenses	<u>31,766,778</u>	<u>31,450,175</u>	1%
Operating Income (Loss)	<u>772,524</u>	<u>(1,294,513)</u>	
Nonoperating Revenues (Expenses):			
Interest income	3,429	7,705	(56%)
Loss on disposal of capital assets	(64,511)	(62,519)	3%
Other income	<u>354,622</u>	<u>651,423</u>	(46%)
Total nonoperating revenues (expenses)	<u>293,540</u>	<u>596,609</u>	(51%)
Income before capital contributions and extraordinary items	1,066,064	(697,904)	
Capital Contributions	99,054	517,149	(83%)
Extraordinary Item	<u>3,000,000</u>	<u>-</u>	
Change in net position	4,165,118	(126,754)	
Net position - beginning of year - as restated	<u>14,827,176</u>	<u>14,953,931</u>	
Net position - end of year	<u>\$ 18,992,294</u>	<u>\$ 14,827,177</u>	28%

San Diego Convention Center Corporation
Management's Discussion and Analysis (Continued)
For the Year Ended June 30, 2014
(Unaudited)

SDCCC FINANCIAL STATEMENT ANALYSIS (Continued)

Operating Revenues

Total operating revenues generated in FY 2014 amounted to \$32.5 million, a \$2.3 million, or 8%, increase compared to the prior year's total of \$30.2 million. The change was primarily due to an increase in food and beverage commission revenues of \$1.3 million, or 18%, as well as increased ancillary services of \$0.9 million, or 8%, compared to prior year as a result of increased event activity and service requirements.

Operating Expenses

Total operating expenses incurred during FY 2014 amounted to \$31.8 million, a \$0.3 million, or 1%, increase compared to the prior year's total of \$31.5 million with offsetting category fluctuations. The change was primarily due to an \$0.8 million, or 4% increase in salaries and benefits related to increased worker's compensation claims costs as well as increased salary and wage costs for both full time and part time staff compared to the prior year. Partially offsetting the increase in salaries and benefits was a \$0.3 million, or 4% decrease in services and supplies expenses related to reduced utility consumption as well as a decrease in depreciation expense of \$0.2 million, or 7% related to major capital projects reaching their depreciable useful life.

Nonoperating Revenues and Expenses

During FY 2014, nonoperating revenues and expenses produced \$0.3 million of net revenues compared to \$0.6 million of net revenues in the prior year. The decrease resulted primarily from the expiration of food and beverage contract signing bonus revenue as well as the cessation of utility rebate programs.

Extraordinary Item

During FY 2014, an extraordinary item totaling \$3.0 million was recognized upon the elimination of a debt obligation related to a loan agreement between the former Redevelopment Agency of the City of San Diego ("RDA") and SDCCC. During FY 2014, the California Department of Finance ("DOF") determined the transfer of the \$3.0 loan agreement between SDCCC and the RDA to the City of San Diego, as the Successor Agency, to be a non-enforceable obligation per redevelopment dissolution law. The DOF determination was only relevant in determining allowable enforceable obligations transferred to the Successor agency through the due diligence review process; it did not in and of itself extinguish SDCCC's contractual debt obligation. However, the loan obligation was satisfied by the City of San Diego's payment of \$3.0 million to the Successor Agency in connection with the DOF Due Diligence determination, therefore eliminating the debt obligation from SDCCC.

San Diego Convention Center Corporation
Management's Discussion and Analysis (Continued)
For the Year Ended June 30, 2014
(Unaudited)

CAPITAL ASSET AND DEBT ANALYSIS

As of June 30, 2014, SDCCC had reported capital asset book value of \$30.0 million, net of accumulated depreciation of \$23.7 million, or less than 1% higher than the prior year figure of \$29.7 million. The capital assets are spread across a broad range of computer, office and operating equipment, telecommunications, leasehold improvements and land. The gross value of capital purchases in FY 2014 of \$2.5 million was partially offset by disposals of \$1.9 million.

Major capital asset additions during FY 2014 included:

- \$484,901 for Phase III expansion capitalized interest
- \$280,473 for bathroom remodeling
- \$249,220 for carpet replacement
- \$211,682 for airwall fabric replacement
- \$171,317 for security camera system upgrade

Effective May 6, 2010, SDCCC entered into a \$12,500,000 note payable with Fifth Avenue Landing, LLC, related to the purchase of a ground lease to be used as the site for a future expansion of the Convention Center's existing building. During FY 2014, a \$500,000 installment for accrued interest expense was retired leaving the principal balance on the note payable at \$12,500,000 and an accrued interest balance of \$736,068.

Effective March 16, 2011, SDCCC entered into a \$3,000,000 note payable with the RDA related to the Phase III expansion project. During FY 2011, SDCCC spent \$1.3 million of the loan proceeds for Phase III expansion project expenditures. As of June 30, 2011, the City of San Diego took over the Phase III expansion project from SDCCC including all remaining loan proceeds and contracts. SDCCC was still the debtor of the note payable to the RDA until the middle of FY 2014 when the DOF determined the debt to be a non-enforceable obligation.

Effective April 25, 2012, SDCCC entered into a zero percent rate per annum On-bill Financing Loan Agreement with San Diego Gas and Electric (SDG&E) for \$417,514, the proceeds of which were used to apply "retro commissioning", a systematic process for improving and optimizing a building's operations through reduced energy usage, lengthened equipment life, and improved indoor air quality and occupant comfort. The obligation is payable over 23 equal installments allocated through SDCCC's monthly utility bill based on estimated energy cost savings. For the year ended June 30, 2014, SDCCC paid \$217,833 in principal payments on the SDG&E loan.

Effective April 15, 2013, SDCCC entered into a commercial lease agreement with CG 7600, LLC (lessor) in which the lessor financed a warehouse capital improvement for SDCCC valued at \$21,972. The agreement calls for the loan to be amortized in SDCCC's monthly rent over 10 years at zero percent interest. In the event SDCCC does not exercise the option to extend, the unamortized portion becomes payable and due upon termination of the contract. For the year ended June 30, 2014, SDCCC paid \$2,197 in principal payments on the warehouse loan.

San Diego Convention Center Corporation
Management's Discussion and Analysis (Continued)
For the Year Ended June 30, 2014
(Unaudited)

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

FY 2014 operational contributions from the City remained at \$3,405,000 for the fourth year in a row. As described in Note 6, contributions from the City funded marketing, promotion and capital projects for the Convention Center. During FY 2014, total expenses for marketing, promotion and capital projects exceeded the City's contributions.

Effective July 1, 2012, approved San Diego City Council action provided for long-term sales, marketing and promotional activities of the Convention Center to be transferred to a third party contractor (the San Diego Tourist Authority (SDTA)). A contract between SDCCC and SDTA exists detailing the terms set forth by the City. For the year ended June 30, 2014, SDCCC paid \$1.9 million in marketing contract payments to SDTA.

Management is anticipating moderate improvement in operational financial performance during FY 2015 as compared to FY 2014. The City's contributions to SDCCC are anticipated to remain at \$3,405,000. If funding is not received by May 5, 2015 to pay for the \$12,500,000 debt obligation due, SDCCC will default on its debt obligation with resulting financial impacts as disclosed in Note 12.

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of SDCCC's finances. Questions concerning any of the information provided in this report or request for additional financial information should be addressed to the President & CEO at the San Diego Convention Center Corporation, 111 West Harbor Drive, San Diego, CA 92101.

THIS PAGE LEFT BLANK INTENTIONALLY

BASIC FINANCIAL STATEMENTS

THIS PAGE LEFT BLANK INTENTIONALLY

San Diego Convention Center Corporation
Statement of Net Position
June 30, 2014

ASSETS

Current assets:

Cash and cash equivalents	\$ 7,051,854
Deposits	1,277,063
Receivables	4,052,770
Prepaid expenses	639,198
Deposits with others	139,334
Total current assets	13,160,219

Noncurrent assets:

Receivables	1,250,000
Land	18,598,170
Furniture, equipment and software	5,784,067
Leasehold improvements	29,289,021
Less accumulated depreciation	(23,718,704)
Total capital assets	29,952,554

Total noncurrent assets	31,202,554
-------------------------	------------

TOTAL ASSETS	44,362,773
---------------------	------------

LIABILITIES

Current liabilities:

Accounts payable	570,994
Accrued liabilities	2,419,123
Unearned income	8,488,671
Compensated employee absences	1,217,873
Current portion of long-term debt	12,629,266
Total current liabilities	25,325,927

Noncurrent liabilities:

Compensated employee absences	27,523
Long-term debt	17,029

Total noncurrent liabilities:	44,552
-------------------------------	--------

TOTAL LIABILITIES	25,370,479
--------------------------	------------

NET POSITION

Net investment in capital assets	17,306,259
Unrestricted	1,686,035
Total net position	18,992,294

TOTAL NET POSITION	\$ 18,992,294
---------------------------	---------------

See accompanying notes to the basic financial statements.

San Diego Convention Center Corporation
Statement of Revenues, Expenses and Changes in Net Position
For the Year Ended June 30, 2014

Operating Revenues

Rental Revenue:

Convention and trade shows	\$ 6,944,217
Consumer shows	574,855
Corporate/incentive events	441,662
Cancelled events	406,046
Community events	306,221
Meetings and seminars	203,240
Local trade shows	113,707

Food and beverage revenue 8,430,578

Ancillary service revenue:

Utilities	3,741,177
Event and cleaning services	3,439,934
Telecommunications	2,726,507
Audio visual	1,312,907
Parking	452,859

Contributions:

City of San Diego 3,405,000

Other revenue 40,392

Total operating revenues 32,539,302

Operating Expenses

Salaries and wages	15,384,542
Fringe benefits	4,460,333
Utilities	3,414,056
Repairs and maintenance	2,035,025
Depreciation	1,935,649
Contractual marketing and sales	1,900,000
General	1,213,946
Insurance	432,928
Contracted services	405,801
Supplies	358,476
Sales and marketing	95,936
Travel and transportation	81,692
Telecommunications	48,394

Total operating expenses 31,766,778

Operating income 772,524

Nonoperating Revenues (Expenses)

Other income 354,622

Interest income 3,429

Loss on disposal of capital assets (64,511)

Total nonoperating revenues (expenses) 293,540

**Income before capital contributions
and extraordinary item**

1,066,064

Capital contributions

99,054

Extraordinary item - forgiveness of RDA loan

3,000,000

Change in net position

4,165,118

Net position - beginning of year

14,827,176

Net position - end of year

\$ 18,992,294

See accompanying notes to the basic financial statements.

San Diego Convention Center Corporation
Statement of Cash Flows (Continued)
For the Year Ended June 30, 2014

CASH FLOWS FROM OPERATING ACTIVITIES

Receipts from customers	\$ 29,157,161
Contributions received from City of San Diego	3,405,000
Payments to suppliers for goods and services	(10,137,985)
Payments to employees for services	(19,661,908)
	2,762,268
Net cash provided by operating activities	2,762,268

**CASH FLOWS FROM CAPITAL AND
RELATED FINANCING ACTIVITIES**

Acquisition and construction of capital assets	(1,937,145)
Principal payments on note payable	(220,031)
Interest paid on long-term debt	(500,000)
Proceeds from the sale of capital assets	7,131
	(2,650,045)
Net cash used by capital and related financing activities	(2,650,045)

CASH FLOWS FROM INVESTING ACTIVITIES

Purchase of investments	(180,063)
Interest received on investments	3,429
	(176,634)
Net cash used by investing activities	(176,634)

NET DECREASE IN CASH AND CASH EQUIVALENTS	(64,411)
--	----------

CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	7,116,265
--	-----------

CASH AND CASH EQUIVALENTS - END OF YEAR	\$ 7,051,854
--	--------------

See accompanying notes to the basic financial statements.

San Diego Convention Center Corporation
Statement of Cash Flows (Continued)
For the Year Ended June 30, 2014

RECONCILIATION OF OPERATING INCOME TO NET

CASH PROVIDED BY OPERATING ACTIVITIES

Operating income	\$	772,524
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation		1,935,649
Other income		354,622
Changes in operating assets and liabilities:		
Increase in receivables		(652,154)
Increase in prepaid expenses		(36,490)
Increase in deposits with others		(139,334)
Increase in accounts payable		103,525
Increase in accrued compensated absences		206,737
Decrease in accrued liabilities		(103,202)
Increase in unearned income		320,391
Net cash provided by operating activities	<u>\$</u>	<u>2,762,268</u>

NONCASH INVESTING, CAPITAL AND FINANCING ACTIVITIES

Forgiveness of RDA loan	\$	3,000,000
Capitalized interest		718,668
Capital asset contributions		99,054
Carrying value of disposition of capital assets		71,642

See accompanying notes to the basic financial statements.

NOTES TO THE BASIC FINANCIAL STATEMENTS

THIS PAGE LEFT BLANK INTENTIONALLY

San Diego Convention Center Corporation
Notes to the Basic Financial Statements
For the Year Ended June 30, 2014

NOTE 1. REPORTING ENTITY

San Diego Convention Center Corporation (SDCCC) is a not-for-profit public benefit corporation originally organized to market, operate and maintain the San Diego Convention Center (Convention Center).

SDCCC acts in accordance with its By-Laws, the City of San Diego's (City) Charter, and the City's Municipal Code. The City appoints seven voting members out of the nine-member Board of Directors of SDCCC. Since the City appoints a majority of the voting members of the Board of Directors of SDCCC and SDCCC provides the bulk of its services directly to the citizens, SDCCC is reported as a discrete component unit of the City of San Diego.

The Convention Center was constructed by the San Diego Unified Port District (District) on land owned by the District. Construction was completed in the fall of 1989 and the Convention Center opened in November 1989. An expansion of the Convention Center that roughly doubled the size of the facility was constructed by the City and completed in September 2001. The City has an agreement with the District to manage the Convention Center.

SDCCC has a management agreement with the City to provide sales and marketing, operating and maintenance services for the Convention Center. The agreement provides that the City will allocate to SDCCC approved budgetary amounts for marketing, promotion and capital projects for the Convention Center (refer to Note 6). On March 20, 2012, the Board of Directors of SDCCC approved a motion that SDCCC enter into an addendum to the management agreement and on April 5, 2012, the San Diego City Council approved action providing for SDCCC to assign certain sales, marketing and promotional activities at the Convention Center to a third party. Effective July 1, 2012, SDCCC entered into a contract with the San Diego Tourist Authority (SDTA) to unify the sales and marketing presence in the marketplace as well as maximize the economic impact related to long-term events at the Convention Center.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. *Basis of Accounting and Measurement Focus*

The financial transactions of SDCCC are accounted for on the accrual basis of accounting under which revenues are recognized as earned and expenses are recognized as incurred. SDCCC distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing event meeting space, goods and services in connection with SDCCC's principal ongoing operations. SDCCC's principal operating revenues include event meeting space rental revenues, food and beverage commissions, event and cleaning service, other ancillary service revenues and contributions from the City that are used to fund marketing, promotion and capital projects. SDCCC's principal operating expenses include salaries and wages, fringe benefits, depreciation and utilities. If not operating, all other revenues and expenses are reported as nonoperating revenues and expenses. When both restricted and unrestricted resources are available for use, it is SDCCC's policy to use restricted resources first, then unrestricted resources as they are needed.

B. *Cash and Cash Equivalents*

SDCCC's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

San Diego Convention Center Corporation
Notes to the Basic Financial Statements (Continued)
For the Year Ended June 30, 2014

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

C. *Prepaid Expenses*

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid expenses.

D. *Accounts Receivable*

Long-term receivables in the amount of \$1,250,000 represent incentive payments to be received by SDCCC in equal installments of \$625,000 on January 1, 2017 and January 1, 2019, from Centerplate in consideration for extending its exclusive food and beverage contract through June 30, 2021.

E. *Capital Assets*

Capital assets are reported at cost. Capital assets are defined as assets with initial cost of more than \$5,000 per item and a useful life of greater than one year. Capital assets are depreciated using the straight-line method over the following estimated useful lives:

	<u>Years</u>
Data processing equipment and software	3
Telecommunication equipment	5
Office furniture and operating equipment	7
Leasehold improvements	15

Expenses incurred related to the Phase III expansion project, including design and entitlement costs, and interest incurred on the ground lease note payable, are included as part of the capitalized value of the related asset.

F. *Unearned Income*

Unearned income represents funds due or received from customers that pertain to enforceable future contractual obligations. Building rent deposits, revenue contract incentive payments and advertising payments are recognized once the event has occurred or the contractual obligation has been fulfilled.

G. *Compensated Employee Absences*

Accumulated annual leave (PTO) is compensated time-off for eligible employees who are absent from work and is recorded in the Statement of Net Position. The amount recorded is expected to be used in accordance with SDCCC's personnel guidelines for vacation, illness, and personal business with a maximum accumulation of 480 hours. Part-time employees who have PTO balances at fiscal year end are paid their annual leave balance within 30 days of fiscal year end. Additionally, full-time employees are allowed up to 80 hours paid compensation in lieu of annual leave provided they maintain a minimum balance of 40 hours.

San Diego Convention Center Corporation
Notes to the Basic Financial Statements (Continued)
For the Year Ended June 30, 2014

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

H. Components of Net Position

Net Investment in Capital Assets - This amount consists of capital assets net of accumulated depreciation and reduced by outstanding debt that is attributed to the acquisition, construction or improvement of the assets.

Unrestricted - This amount is the portion of net position that does not meet the definition of “net investment in capital assets”.

I. Income Taxes

SDCCC has received notice from the Internal Revenue Service that it is exempt from federal income taxes pursuant to Section 501 (c) (3) of the Internal Revenue Code. SDCCC is also exempt from state franchise taxes on related income pursuant to California Revenue and Taxation Code Section 23701(d).

J. Use of Estimates

The preparation of financial statements in conformity with United States generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates. Management believes that the estimates made are reasonable.

NOTE 3. CASH AND INVESTMENTS

At June 30, 2014, the book balance of SDCCC's cash on hand, deposits, non-negotiable certificates of deposit and bank money market account deposits was \$8,328,917, and the bank balance was \$8,196,696. Of the bank balance, \$500,000 was covered by Federal depository insurance. The remaining uninsured balance is collateralized with the collateral held by an affiliate of the counterparty's financial institution. Neither the bank money market account deposits nor the certificates of deposit are rated by credit rating agencies. The \$1,277,063 invested in non-negotiable certificates of deposit bear interest rates of 0.3% and have maturities greater than 3 months and less than one year. SDCCC developed a formal deposit and investment policy that was approved in August 2010 which addresses custodial credit risk, credit quality risk and allowable investments. SDCCC places no limit on the amount that may be invested in any one account or fund. SDCCC's allowable investments include: obligations of the U.S. government, its agencies and instrumentalities; investment grade state and local government securities; certificates of deposits; bankers' acceptances; repurchase agreements; and money market mutual funds whose portfolios consist only of domestic securities.

Cash deposits and investments were categorized as follows at June 30, 2014:

Cash on hand	\$ 108,899
Deposits	1,274,058
Certificates of deposit (non-negotiable)	1,277,063
Bank money market account deposits	<u>5,668,897</u>
Total cash and investments	<u><u>\$ 8,328,917</u></u>

San Diego Convention Center Corporation
Notes to the Basic Financial Statements (Continued)
For the Year Ended June 30, 2014

NOTE 4. CAPITAL ASSETS

A summary of changes in capital assets for the year ended June 30, 2014, is as follows:

	<u>Beginning Balance June 30, 2013</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending Balance June 30, 2014</u>
Non-Depreciable Capital Assets:				
Land	\$ 18,113,270	\$ 731,167	\$ (246,267)	\$ 18,598,170
Depreciable Capital Assets:				
Furniture, equipment and software	6,684,160	428,585	(1,328,678)	5,784,067
Leasehold improvements	28,259,933	1,398,253	(369,165)	29,289,021
Total Depreciable Capital Assets:	34,944,093	1,826,838	(1,697,843)	35,073,088
Less Accumulated Depreciation:				
Furniture, equipment and software	(5,905,086)	(283,489)	1,306,645	(4,881,930)
Leasehold improvements	(17,482,714)	(1,652,160)	298,100	(18,836,774)
Total Accumulated Depreciation	(23,387,800)	(1,935,649)	1,604,745	(23,718,704)
Total Depreciable Capital Assets - Net	11,556,293	(108,811)	(93,098)	11,354,384
Capital Assets, Net	\$ 29,669,563	\$ 622,356	\$ (339,365)	\$ 29,952,554

Depreciation expense for the year ended June 30, 2014 was \$1,935,649.

NOTE 5. LONG-TERM LIABILITIES

A. *Compensated employee absences*

A summary of changes in accrued compensated employee absences for the year ended June 30, 2014 is as follows:

	<u>Balance June 30, 2013</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance June 30, 2014</u>	<u>Current Portion</u>
Compensated Employee Absences	\$ 1,154,597	\$ 1,411,176	\$ (1,320,377)	\$ 1,245,396	\$ 1,217,873

B. *Notes Payable*

- SDCCC entered into a non-recourse Note Purchase Contract on May 6, 2010, for \$12,500,000 with Fifth Avenue Landing LLC (FAL), the proceeds of which were used for the Phase III expansion site ground lease purchase. The Fifth Avenue Landing LLC note payable is repaid at a rate of 5.27% per annum, simple interest, with a \$12,500,000 principal payment due by May 6, 2015. SDCCC is required to pay an annual interest payment of \$500,000, while the remaining accrued interest owed in any one year is payable at the date of final maturity.

San Diego Convention Center Corporation
Notes to the Basic Financial Statements (Continued)
For the Year Ended June 30, 2014

NOTE 5. LONG-TERM LIABILITIES (Continued)

B. Notes Payable (continued)

2. On April 25, 2012, SDCCC entered into a Financing Loan Agreement at a zero percent per annum rate with SDG&E for \$417,514, the proceeds of which were used to apply "retrocommissioning", a systematic process for improving and optimizing a building's operations through reduced energy usage, lengthened equipment life, and improved indoor air quality and occupant comfort. The obligation is payable in 23 equal installments through an on-bill financing arrangement through SDCCC's monthly utility bill based on estimated energy cost savings.

3. On April 15, 2013, SDCCC entered into a commercial lease agreement with CG 7600, LLC (lessor) in which the lessor financed a warehouse capital improvement for SDCCC valued at \$21,972. The agreement calls for the loan to be amortized as part of SDCCC's monthly rent over 10 years at a zero percent per annum rate. In the event SDCCC does not exercise the option to extend, the unamortized portion becomes payable and due upon termination of the contract.

A summary of changes in notes payable for the year ended June 30, 2014, are as follows:

	Balance June 30, 2013	Additions	Retirements	Balance June 30, 2014	Current Portion
Fifth Avenue Landing LLC	\$ 12,500,000	\$ -	\$ -	\$ 12,500,000	\$ 12,500,000
San Diego Gas & Electric - Retrocommissioning	344,903	-	(217,834)	127,069	127,069
CG 7600 LP	21,423	-	(2,197)	19,226	2,197
Successor Agency of the Redevelopment Agency of the City of San Diego	3,000,000	-	(3,000,000)	-	-
Total	\$ 15,866,326	\$ -	\$ (3,220,031)	\$ 12,646,295	\$ 12,629,266

Annual requirements to amortize the notes payable as of June 30, 2014, including interest payments to maturity are as follows:

Year Ending June 30,	Principal	Interest	Total
2015	\$ 12,629,266	\$ 1,297,359	\$ 13,926,625
2016	2,197	-	2,197
2017	2,197	-	2,197
2018	2,197	-	2,197
2019	2,197	-	2,197
2020-2023	8,241	-	8,241
Total	\$ 12,646,295	\$ 1,297,359	\$ 13,943,654

San Diego Convention Center Corporation
Notes to the Basic Financial Statements (Continued)
For the Year Ended June 30, 2014

NOTE 6. ECONOMIC DEPENDENCY

SDCCC receives contributions from the City as specified in a management agreement between SDCCC and the City. The agreement provides that the City will allocate to SDCCC approved budgetary amounts for marketing, promotion and capital projects for the Convention Center. During the year ended June 30, 2014, SDCCC received \$3,405,000 from the City, of which, \$1,900,000 was used to fund marketing contract expenses paid to the San Diego Tourist Authority, related to certain sales, marketing and promotional aspects of long-term events at the Convention Center. The remaining \$1,505,000 was used to fund various capital projects completed during the year.

Moving into FY 2015, SDCCC anticipates contributions from the City to remain at \$3,405,000 with offsetting marketing contract expenses of \$1,931,000. The remaining \$1,474,000 is earmarked to fund capital projects at the Convention Center.

NOTE 7. PENSION PLAN

The San Diego Convention Center Corporation's Money Purchase Pension Plan (Plan) is a governmental plan under section 414(d) of the Internal Revenue Code, which was established effective January 1, 1986, by SDCCC's Board of Directors. The Plan is administered by SDCCC through a Defined Contribution Committee, represented by the SDCCC Board and staff, who act by a majority of its members in office to carry out the general administration of the Plan. Any recommended Plan amendments are subject to the approval and adoption by SDCCC's Board of Directors. As part of the Plan, SDCCC through Board action selected Wells Fargo & Company as Trustee, to hold and administer Plan assets subject to the terms of the Plan. The Plan is a qualified defined contribution plan and as such, benefits depend on amounts contributed to the Plan plus investment earnings less allowable plan expenses. The Plan covers all employees who have completed at least 1,000 or more hours in one year and are not covered through a union retirement plan. Employees are eligible to participate in the Plan on the first day of the month after completion of 1,000 hours of service during the twelve-month period beginning from the employees hire date (or during any subsequent Plan year). For each Plan year, SDCCC contributes 10% of compensation paid after becoming an eligible participant which is transferred to the trustee on behalf of each qualifying individual.

A Plan year is defined as a calendar year. The balance in the Plan for each eligible employee is vested gradually over five years of continuing service with an eligible employee becoming fully vested after five years. Forfeitures and Plan expenses are allocated in accordance with Plan provisions. A trustee bank holds the Plan assets.

For the year ended June 30, 2014, pension expense amounted to \$1,106,533, with no employee contributions made to the Plan. SDCCC records pension expense during the fiscal year based upon employee compensation that is included in gross income covered compensation.

NOTE 8. SUPPLEMENTAL DEFERRED COMPENSATION PLAN

The SDCCC Supplemental Deferred Compensation Plan (NQ Plan), administered by SDCCC, is a voluntary, non-qualified defined contribution plan covering all employees of SDCCC who are eligible for membership as defined by the NQ Plan document and who elect to participate in the NQ Plan. The NQ Plan identifies eligible employees as those designated as eligible by the Board, provided that each employee qualifies as a member of the select group of SDCCC's management or highly compensated employees. The NQ Plan operates under the authority of section 457(f) of the Internal Revenue Code as well as under the direction of the Board of SDCCC.

San Diego Convention Center Corporation
Notes to the Basic Financial Statements (Continued)
For the Year Ended June 30, 2014

NOTE 8. SUPPLEMENTAL DEFERRED COMPENSATION PLAN (Continued)

SDCCC may contribute, on behalf of an eligible employee, amounts of money that it deems appropriate. The amounts to be contributed, if any, are determined by the Board of Directors. The contributions are deposited into the SDCCC contribution credit account, maintained on behalf of the participants.

The NQ Plan became effective October 1, 2005. During the year ended June 30, 2014, SDCCC contributed \$6,359 on behalf of the eligible employees.

NOTE 9. COMMITMENTS

SDCCC as Lessor

Effective, March 22, 2013, SDCCC entered into a sublease agreement for truck marshal yard space for an initial term of 60 months, from April 1, 2013 through March 31, 2018. Future minimum annual rental lease revenues are as follows:

Year Ending June 30,	Amount
2015	\$ 126,277
2016	129,863
2017	135,522
2018	102,358
Total	\$ 494,020

Rental income related to the sublease was \$123,332 for the year ended June 30, 2014.

SDCCC as Lessee

SDCCC has noncancelable operating leases with terms greater than one year for photocopiers as well as truck marshal yard and warehouse space. The lease commitments are as follows:

Year Ending June 30,	Amount
2015	\$ 220,400
2016	225,795
2017	197,646
2018	151,436
Total	\$ 795,277

Lease expense for the year ended June 30, 2014 was \$258,265.

San Diego Convention Center Corporation
Notes to the Basic Financial Statements (Continued)
For the Year Ended June 30, 2014

NOTE 10. CONTINGENT LIABILITIES

SDCCC is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disaster.

SDCCC is subject to various lawsuits as well as grievances by labor unions. SDCCC's management believes, based upon consultation with SDCCC attorneys, that any unasserted claims, in the aggregate, are not expected to result in a material adverse financial impact on SDCCC. SDCCC is covered by various insurance policies, the largest of which include property, liability and workers' compensation with deductibles that vary from \$25,000 to \$100,000. On June 11, 2013, the San Diego Unified Port District Board of Port Commissioners passed a resolution to eliminate earthquake and flood insurance coverage for the Convention Center due to earthquake loss predictably reports and analysis of projected sustained loss compared to deductible limits. SDCCC management believes that SDCCC's insurance programs are sufficient to cover any potential losses should an unfavorable outcome materialize. There were no insurance claim settlements that exceeded insurance coverage during the past three fiscal years.

NOTE 11. EXTRAORDINARY ITEM

During FY 2014, SDCCC recognized an extraordinary item totaling \$3.0 million due to the elimination of a debt obligation related to a loan agreement between the former Redevelopment Agency of the City of San Diego ("RDA") and SDCCC. Pursuant to Assembly Bill (AB) 1484, the California Department of Finance ("DOF") retroactively invalidated the transfer of the \$3.0 loan agreement between SDCCC and the RDA to the City of San Diego, as the Successor Agency, to be a non-enforceable obligation per redevelopment dissolution law. The DOF determination was only relevant in determining allowable enforceable obligations transferred to the Successor Agency through the due diligence review process; it did not in and of itself extinguish SDCCC's contractual debt obligation. However, the loan obligation was satisfied by the City of San Diego's payment of \$3.0 million to the Successor Agency in connection with the DOF Due Diligence determination, therefore eliminating the debt obligation from SDCCC.

NOTE 12. SUBSEQUENT EVENT

On May 6, 2010, SDCCC entered into a non-recourse note purchase contract with Fifth Avenue Landing LLC (FAL) that will mature on May 6, 2015. In July 2014, a state appeals court ruled the funding mechanism for the Phase III expansion to be unconstitutional because it was not approved by public vote, leaving the City of San Diego and SDCCC in a precarious state to determine how to move forward with the Phase III expansion site. If SDCCC does not receive funding to satisfy the note payable obligation, SDCCC will default on payment of the obligation and the land will revert back to Fifth Avenue Landing LLC, as the remedy of SDCCC's default is limited to the collateral, relieving SDCCC of further liability. The financial impact of default on the note payable to SDCCC would be the following:

- elimination of the \$12,500,000 note payable upon default since the collateral will revert back to FAL as remedy of the non-recourse debt offset by a reduction in capital assets representing the land value.
- \$1,297,359 of unpaid accrued interest payable will be uncollectible by FAL due to the non-recourse debt provisions, thereby eliminating the interest payable liability with an offsetting reduction in capital assets, in addition to an increase in unrestricted net position directly offset by a decrease in the net investment of capital assets.
- \$3,000,000 capitalized asset costs will be expensed as loss on disposal, increasing non-operating expenses of the financial statements with an offsetting reduction in the net investment in capital assets.

OTHER REPORT

THIS PAGE LEFT BLANK INTENTIONALLY

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Board of Directors
San Diego Convention Center Corporation
City of San Diego, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the San Diego Convention Center Corporation (SDCCC), a component unit of the City of San Diego, California (City), as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise SDCCC's basic financial statements, and have issued our report thereon dated October 28, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered SDCCC's internal control over financial reporting (internal control) to determine the 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 SDCCC's internal control. Accordingly, we do not express an opinion on the effectiveness of SDCCC's internal control.

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 a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity'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 consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether SDCCC's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Macias Gini & O'Connell LLP

San Diego, California
October 28, 2014