



Office of the City Auditor

**Report to the City Council
City of San José**

**THE 2007-08 ANNUAL
PERFORMANCE AUDIT OF
TEAM SAN JOSE, INC.**

**Team San Jose Improved Its Overall
Performance And Met Three Of Its Four
Performance Measure Targets In 2007-08**

**Three Of The Six Open Audit
Recommendations Are Implemented, Two
Remain Partly Implemented And One
Recommendation Is Not Implemented**

**Report 09-02
February 2009**

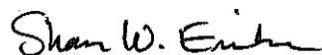
February 11, 2009

Honorable Mayor and Members
of the City Council
200 East Santa Clara Street
San Jose, CA 95113

Transmitted herewith is a report on *The 2007-08 Annual Performance Audit Of Team San Jose, Inc.* This report is in accordance with City Charter Section 805. An Executive Summary is presented on the blue pages in the front of this report. Both the City Administration's response and Team San Jose, Inc.'s response are shown on the yellow pages before the appendix.

This report will be presented to the *Public Safety, Finance & Strategic Support Committee* at its February 19, 2009 meeting. If you need any additional information, please let me know. The City Auditor's staff member who participated in the preparation of this report is Carolyn Huynh.

Respectfully submitted,



Sharon W. Erickson
City Auditor

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Executive Summary

In accordance with the City Auditor's 2008-09 Audit Workplan, we audited Team San Jose, Inc. (TSJ) to determine whether it met the performance measures and other requirements specified in the *Agreement for the Management of the San Jose Convention Center and Cultural Facilities between the City of San Jose and Team San Jose, Inc.* (Management Agreement) for 2007-08. The 2007-08 audit concludes year four of the five-year term of the Management Agreement.

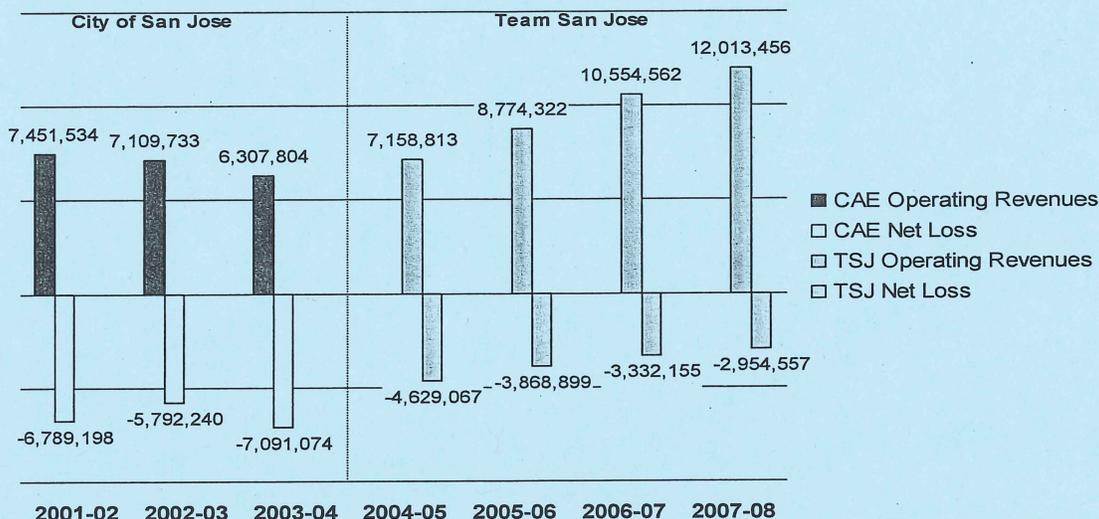
We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions. We limited our work to those areas specified in the Objectives, Scope, and Methodology section of this audit report.

The City Auditor's Office would like to thank Team San Jose, Inc, the San Jose Convention and Visitors Bureau, the City Manager's Office, and the Finance Department who gave their time, information, insight, and cooperation during the audit process.

Finding I Team San Jose Improved Its Overall Performance And Met Three Of Its Four Performance Measure Targets In 2007-08

Section 4.9 of the Management Agreement outlines four key performance measures and requires TSJ to submit a monthly report to the City. The performance measures track revenue and financial performance, economic impact, and customer service. We found that TSJ has met three of its four performance measures and has improved its overall performance. Specifically, from 2004 to 2008, TSJ's operating revenues have increased by an average of 18.9% per year and net losses have decreased by an average of 13.9% per year. As shown below, TSJ's performed better as compared to the period when the City operated the Facilities.

Exhibit: Comparison Of The Operating Revenues And Net Loss (in dollars) Generated Under CAE Management To TSJ Management¹



Source: Auditor-generated using information from TSJ’s audited financial statements.

TSJ Met Three Of Its Four Performance Measure Targets In 2007-08

Section 4.9 of the Management Agreement outlines four key performance measures and requires TSJ to submit a monthly report to the City. The measures track revenue and financial performance, economic impact, and customer service:

1. **Gross Revenues:** TSJ will focus on increasing gross revenues for the Facilities. Gross Revenues will be aggregated from all sources for all Facilities and detailed by category, including rental income, food and beverage commissions, services, and other revenue streams.
2. **Net Profit or Loss Financial Performance:** TSJ will focus on reducing the City’s operational subsidy to support the Convention and Cultural Facilities.
3. **Economic Impact:** TSJ will focus on increasing the total attendance for events held at the Convention and Cultural Facilities.
4. **Customer Service Results:** TSJ will ask the decision-maker of each event to rate their overall satisfaction with the product and services provided.

¹ We compared TSJ’s operating revenues and net loss for the 2004 to 2008 years to 2001-2004 (three years in which the City managed the Facilities). To determine the Convention, Arts, and Entertainment Department’s (CAE) revenues in the prior years, only those revenues that were comparable to the revenues that TSJ generated were included. To estimate CAE’s net loss from 2001-04, expenses were deducted from operating revenues. The CAE’s operating revenues do not include revenues generated by the California Theater or South Hall as these two facilities were not yet built or operated by the City.

We found for 2007-08 that TSJ:

- Exceeded its gross revenues performance measure by \$710,456;
- Experienced a net loss of \$2,954,557 which was \$1,979,557 more than its target;
- Overall, met its economic impact performance measure; and
- Met its customer service results performance measure.

Exhibit 3 summarizes TSJ's performance:

Exhibit 3: TSJ's 2007-08 Performance Overview

| 2007-08 Performance Measures | Management Agreement Target | Actual | Performance Measure Met | Variance To Actual To Agreement | % Variance Of Actual To Agreement |
|------------------------------|-----------------------------|--------------|-------------------------|---------------------------------|-----------------------------------|
| Gross Revenues | \$11,303,000 | \$12,013,456 | Yes | \$710,456 | 6.3% |
| Net Loss | \$975,000 | \$2,954,557 | No | (\$1,979,557) | (203.0%) |
| Economic Impact | \$785,600 | \$1,679,749 | Yes | \$894,149 | 113.8% |
| Customer Service Results | 89% | 98% | Yes | 9 percentage points | 10.1% |

The City Has Elected To Award TSJ The Full Management Fee For 2007-08

While the Agreement states that *the City* has the right to delete the fixed payment of \$150,000 from the present management fee, it is unclear who has the authority to do so.

RECOMMENDATIONS

We recommend that the City Manager:

- Recommendation #1** Request that the City Council ratify the decision by the Administration to waive its right to delete the fixed payment of \$150,000 from the preset management fee for year four and, potentially, year five of the current Management Agreement. (Priority 1)

**Finding II Three Of The Six Open Audit Recommendations
Are Implemented, Two Remain Partly
Implemented And One Recommendation Is Not
Implemented**

The Office of the City Auditor has issued two previous audit reports for 2004 to 2007 to determine whether TSJ met the performance measures and other requirements specified in the Management Agreement.

The Office of the City Auditor prepares a semi-annual report on the status of outstanding audit recommendations. As of June 30, 2008, there were six outstanding audit recommendations remaining. The following provides a summary of the current status of these six recommendations (for period ending December 31, 2008). In total, three recommendations have been implemented, two remain partly implemented, and one has not been implemented.

Introduction

In accordance with the City Auditor's 2008-09 Audit Workplan, we audited Team San Jose, Inc. (TSJ) to determine whether it met the performance measures and other requirements specified in the *Agreement for the Management of the San Jose Convention Center and Cultural Facilities between the City of San Jose and Team San Jose, Inc.* (Management Agreement) for 2007-08. The 2007-08 audit concludes year four of the five-year term of the Management Agreement.

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions. We limited our work to those areas specified in the Objectives, Scope, and Methodology section of this audit report.

The City Auditor's Office would like to thank Team San Jose, Inc, the San Jose Convention and Visitors Bureau, the City Manager's Office, and the Finance Department who gave their time, information, insight, and cooperation during the audit process.

Background

Team San Jose, Inc. (TSJ) is a private, non-profit corporation created specifically to manage and operate the Convention and Cultural Facilities (the Facilities). TSJ is a joint effort between TSJ staff, the San Jose Convention & Visitors Bureau (CVB), Centerplate (TSJ's food and beverage concessionaire), City employees, and other contracted employees.

The Facilities include three convention facilities and three cultural facilities. The convention facilities are: San Jose McEnery Convention Center, Civic Auditorium, and Parkside Hall. The cultural facilities are Center for the Performing Arts, Montgomery Theater, and California Theater.

On June 22, 2004, the San Jose City Council (City Council) approved a Management Agreement with TSJ to manage and operate the Facilities for a five-year period, beginning July 1, 2004 and ending June 30, 2009. On December 17, 2007, the City Council agreed to extend the term of the Management Agreement for an additional five-year period beginning July 1, 2009 and ending June 30, 2014.

The Facilities, under the management of TSJ, generate revenues which help fund the operations. Other sources of revenue include the Transient Occupancy Tax Fund, the Parking Fund, and the General Fund. Exhibit 1 illustrates the different funding sources for the operation of the Facilities.

Exhibit 1: Source And Uses For Fund 536 (Convention And Cultural Affairs Fund) From 2004-05 Through 2007-08

| | 2004-05 Actual | 2005-06 Actual | 2006-07 Actual | 2007-08 Actual |
|--|---------------------------|---------------------------|---------------------------|---------------------------|
| SOURCES OF FUNDS | | | | |
| Beginning Fund Balance | (\$491,171) | (\$101,660) | \$728,779 | \$4,402,575 ¹ |
| Operating Revenues | 6,719,361 | 8,750,372 | 10,236,913 | 11,544,681 |
| Transfers from General Fund | 1,725,000 | | 1,145,857 | |
| Transfers from General Purpose Parking | 620,000 | 892,823 | 583,000 | 1,249,973 |
| Transfers from Transient Occupancy Tax | 3,813,083 | 4,922,103 | 6,338,040 | 7,213,565 |
| Other | 480 | 3,625 | 20,145 | 16,213 |
| TOTAL | \$12,386,773 | \$14,467,263 | \$19,052,734 | \$24,427,007 |
| USES OF FUNDS | | | | |
| Operating Expenditures | \$12,279,487 | \$13,541,254 | \$14,419,553 | \$15,617,301 |
| Other | 208,946 | 197,230 | 214,393 | 514,108 |
| TOTAL | \$12,488,433 | \$13,738,484 | \$14,633,946 | 16,131,409 |
| Ending Fund Balance | (\$101,660) | \$728,779 | \$4,418,788 | \$8,295,598 |

Source: City of San Jose operating budget from 2004 to 2007, 2008 Comprehensive Annual Financial Report, and Finance Department.

Objectives, Scope, And Methodology

The objectives of our audit were to determine whether TSJ met its performance measures as specified in the Management Agreement for 2007-08 as well as provide the status of the outstanding audit recommendations from the 2004-05, 2005-06 and 2006-07 annual performance audits of Team San Jose.

We limited our scope to reviewing the performance measures and explaining significant variances to 2006-07 information. We also provide an update of the status of open audit recommendation from previous years'

¹According to the Finance Department, the discrepancy of \$16,213 from the 2006-07 ending fund balance and the 2007-08 beginning fund balance is due to a timing difference representing interest income as reported in the 2007-08 Comprehensive Annual Financial Report.

reports. To determine whether TSJ met its performance measures for gross revenues, net loss, economic impact, and customer service results, we did the following:

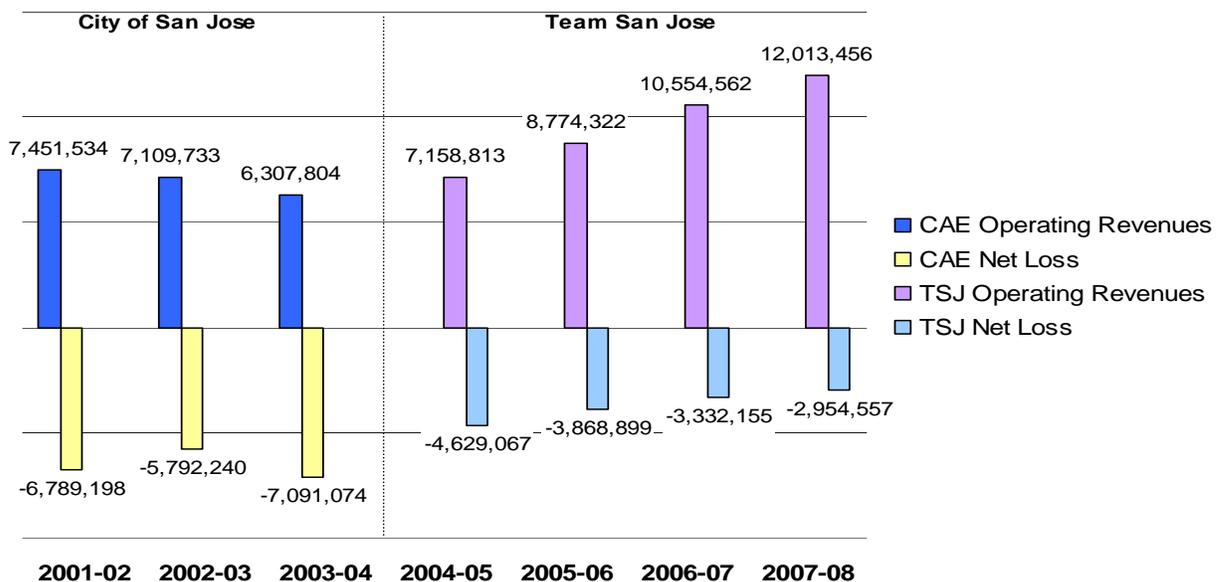
- Reviewed the Management Agreement for target gross revenues, net loss, economic impact, and customer service results;
- Obtained and reviewed the audited financial statements for 2007-08;
- Interviewed TSJ's external auditor at Macias, Gini, & O'Connell, LLP (MGO) regarding questions related to financial statements;
- Obtained and reviewed TSJ's annual attendance report for 2007-08;
- Interviewed the TSJ Business Manager on updates to attendance reporting guidelines and procedures and observed testing on accuracy of attendance report data for 2007-08;
- Obtained and reviewed TSJ's customer service surveys for 2007-08; and
- Reviewed sample of month end report to the City.

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Finding I Team San Jose Improved Its Overall Performance And Met Three Of Its Four Performance Measure Targets In 2007-08

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Exhibit 2: Comparison Of The Operating Revenues And Net Loss (in dollars) Generated Under CAE Management To TSJ Management²



Source: Auditor-generated using information from TSJ's audited financial statements.

² We compared TSJ's operating revenues and net loss for the 2004 to 2008 years to 2001-2004 (three years in which the City managed the Facilities). To determine the Convention, Arts, and Entertainment Department's (CAE) revenues in the prior years, only those revenues that were comparable to the revenues that TSJ generated were included. To estimate CAE's net loss from 2001-04, expenses were deducted from operating revenues. The CAE's operating revenues do not include revenues generated by the California Theater or South Hall as these two facilities were not yet built or operated by the City.

TSJ Met Three Of Its Four Performance Measure Targets In 2007-08

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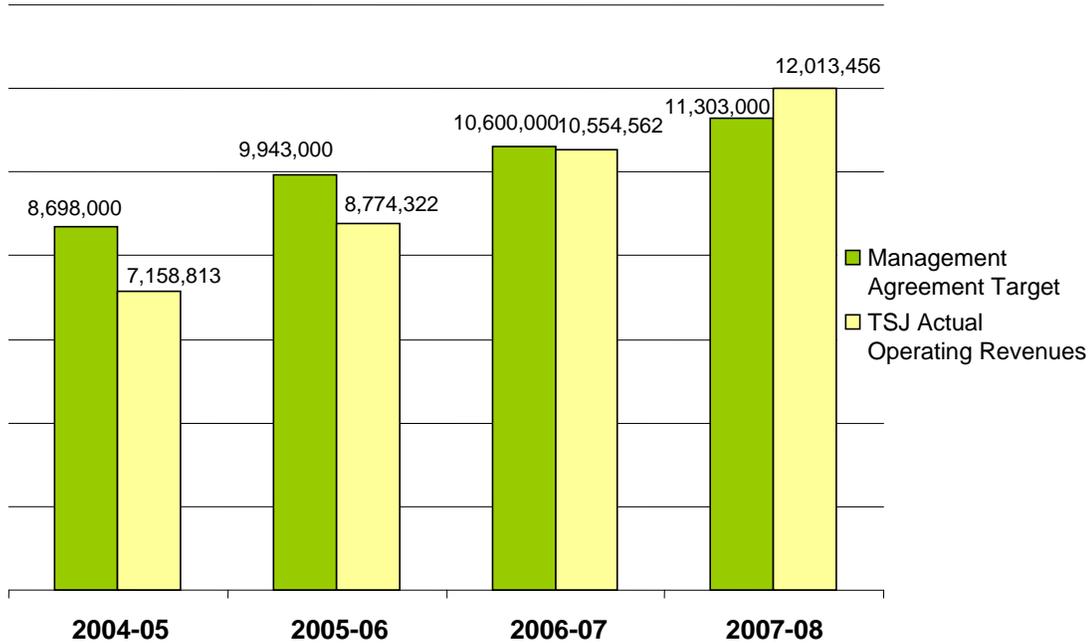
Exhibit 3: TSJ’s 2007-08 Performance Overview

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| Net Loss | \$975,000 | \$2,954,557 | No | (\$1,979,557) | (203.0%) |
| Economic Impact | \$785,600 | \$1,679,749 | Yes | \$894,149 | 113.8% |
| Customer Service Results | 89% | 98% | Yes | 9 percentage points | 10.1% |

TSJ Met Its Performance Measure For Gross Revenues

The first performance measure requires TSJ to achieve specific gross revenue targets for each fiscal year of the agreement. As shown below, in 2007-08 TSJ’s gross revenues were \$12,013,456 or 6.3 percent greater than the gross revenues target specified in the Management Agreement.³ Exhibit 4 compares the Management Agreement gross revenues performance measure to TSJ’s actual gross revenues for the 2004 to 2008.

Exhibit 4: Comparison Of TSJ’s Management Agreement Gross Revenues Targets To Actual Gross Revenues (in dollars) For 2004 To 2008



| Fiscal Year | Management Agreement Target | TSJ Actual Operating Revenues | Variance Of Actual To Management Agreement Target | % Variance Of Actual To Management Agreement Target |
|-------------|-----------------------------|-------------------------------|---|---|
| 2004-05 | \$8,698,000 | \$7,158,813 | (\$1,539,187) | (17.7%) |
| 2005-06 | \$9,943,000 | \$8,774,322 | (\$1,168,678) | (11.8%) |
| 2006-07 | \$10,600,000 | \$10,554,562 | (\$45,438) | (0.4%) |
| 2007-08 | \$11,303,000 | \$12,013,456 | \$710,456 | 6.3% |

Source: Auditor-generated using TSJ’s audited financial statement for 2007-08.

³ For purposes of determining TSJ’s actual gross revenues for performance measuring purposes, City of San Jose credits for facility usage and power charges are included.

Operating Revenue Improved By 13.8 Percent In Year Four

Exhibit 5 breaks out TSJ’s operating revenues by category from year one to year four. Operating revenue improved by 13.8 percent from 2006-07 to 2007-08, including increases in Building rentals, Food and beverage services, and labor charges. This was offset by a significant decrease in the ‘Other revenues’. According to TSJ’s external auditor, the increase in labor charges was principally due to bringing usher services in-house rather than outsourcing as done in prior years, and the decrease in “Other revenues” was largely due to a reclassification of an item into “Labor”.

Exhibit 5: Comparison Of TSJ’s Operating Revenues From 2004 To 2008

| Operating Revenues: | Year One 2004-05 | Year Two 2005-06 | Year Three 2006-07 | Year Four 2007-08 | Variance From Yr 3 To 4 | % Variance From Yr 3 To 4 |
|-----------------------------------|-----------------------------|-----------------------------|-------------------------------|------------------------------|--|--|
| Building rental | \$4,194,140 | \$4,489,668 | \$5,078,075 | \$5,855,214 | \$777,139 | 15.3% |
| Food and beverage services | 1,209,721 | 2,048,213 | 2,521,900 | 2,760,809 | 238,909 | 9.5% |
| Event electrical/utility services | 460,927 | 619,297 | 737,676 | 834,180 | 96,504 | 13.1% |
| Heat and power services charges | 551,427 | 520,262 | 771,870 | 794,488 | 22,618 | 2.9% |
| Networking services | 245,000 | 481,584 | 482,964 | 450,086 | (32,878) | (6.8%) |
| Audio/visual services | 266,438 | 298,588 | 431,674 | 475,843 | 44,169 | 10.2% |
| Other revenues | 59,772 | 140,084 | 294,046 | 184,369 | (109,677) | (37.3%) |
| Telecommunications services | 99,731 | 90,226 | 117,310 | 118,295 | 985 | 0.8% |
| Equipment rentals | 56,988 | 46,262 | 59,977 | 65,773 | 5,796 | 9.7% |
| Labor | 14,669 | 40,138 | 59,070 | 474,399 | 415,329 | 703.1% |
| TOTAL OPERATING REVENUES | \$7,158,813 | \$8,774,322 | \$10,554,561 | \$12,013,456 | \$1,458,895 | 13.8% |
| AGREEMENT TARGET | \$8,698,000 | \$9,943,000 | \$10,600,000 | \$11,303,000 | | |

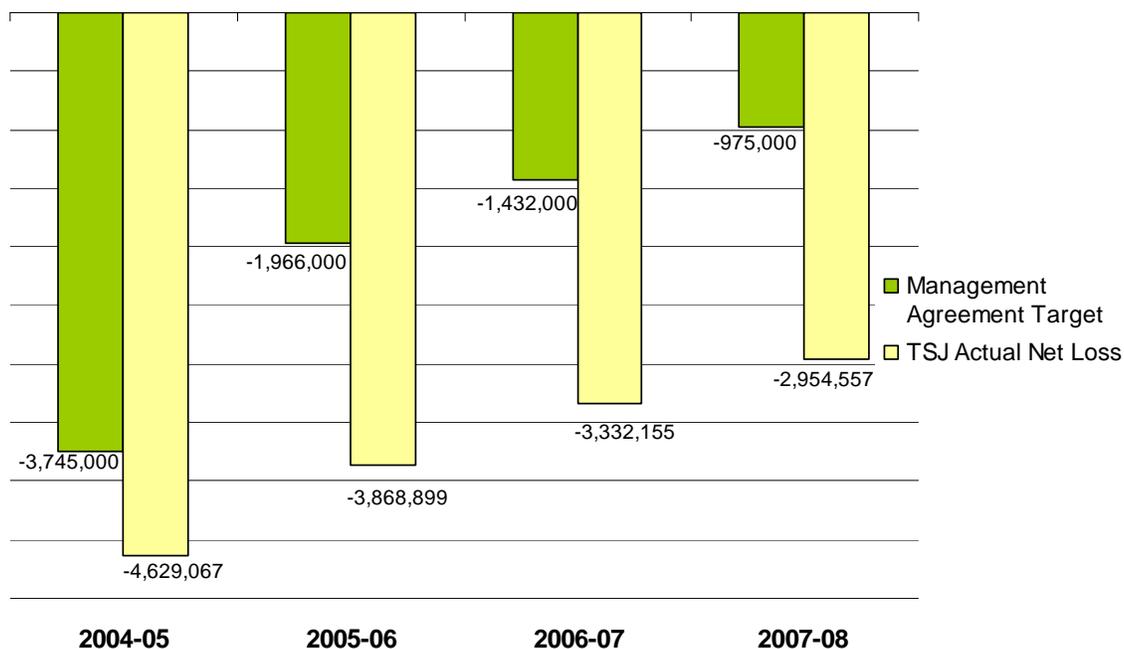
Source: Auditor-generated using TSJ’s audited financial statements from 2004 to 2008.

TSJ Did Not Meet Its Net Loss Performance Measure By \$1,979,557⁴

The second performance measure requires TSJ to achieve specific net loss targets for each fiscal year of the agreement. While TSJ has not met its net loss targets during the term of this agreement, it is important to note that TSJ has reduced its net loss by an average yearly rate of 13.9 percent. Exhibit 6 compares the Management Agreement net loss performance measure to TSJ’s actual net loss from 2004 to 2008.

⁴ For performance measure purposes, expenses do not include depreciation, fire insurance, City oversight, and City funded repairs and maintenance.

Exhibit 6: Comparison Of TSJ’s Management Agreement Net Loss Targets To Actual Net Loss For 2004 To 2008



| Fiscal Year | Management Agreement Target | TSJ Actual Net Loss | Variance Of Actual To Management Agreement | % Variance Of Actual To Management Agreement |
|-------------|-----------------------------|---------------------|--|--|
| 2004-05 | (\$3,745,000) | (\$4,629,067) | (\$884,067) | (23.6%) |
| 2005-06 | (\$1,966,000) | (\$3,868,899) | (\$1,902,899) | (96.8%) |
| 2006-07 | (\$1,432,000) | (\$3,332,155) | (\$1,900,155) | (132.7%) |
| 2007-08 | (\$975,000) | (\$2,954,557) | (\$1,979,557) | (203.0%) |

Source: Auditor-generated using TSJ’s audited financial statement for 2007-08.

It should be noted that although TSJ made progress in reducing the net loss in years one through four by increasing revenue, expenses also rose. For example, as shown in Exhibit 7, TSJ showed significant cost increases in the categories of: Administrative and general salaries, Workers’ compensation insurance premiums, and other. The biggest increase (\$723,566) in Administrative and general salaries was due to an 8% salary increase, the hiring of five additional full-time equivalent employees, additional wages and benefits for employees who in the prior year were hired and only worked part of the year compared to working a full year in the current year, and salaries for ushers.

Exhibit 7: Comparison Of Operating Expenses TSJ Incurred From Year One To Year Four

| | Year One 2004-05 | Year Two 2005-06 | Year Three 2006-07 | Year Four 2007-08 | Variance From Yr 3 To 4 | % Variance From Yr 3 To 4 |
|--|-----------------------------|-----------------------------|-------------------------------|------------------------------|--|--|
| Operating Expenses: | | | | | | |
| City of San Jose management and administrative charges | \$6,228,160 | \$5,820,023 | \$6,645,397 | \$6,754,513 | \$109,116 | 1.6% |
| Utilities | 2,335,139 | 2,467,647 | 2,535,946 | 2,595,186 | 59,240 | 2.3% |
| Administrative and general salaries - Team San Jose | 645,366 | 872,271 | 1,237,668 | 1,972,234 | 734,566 | 59.4% |
| Contracted outside services | 516,980 | 714,818 | 461,066 | 421,067 | (39,999) | (8.7%) |
| Other expenses | 317,857 | 668,446 | 763,447 | 869,202 | 105,755 | 13.9% |
| Overhead - City of San Jose | 542,368 | 555,116 | 865,262 | 911,940 | 46,678 | 5.4% |
| Operating supplies | 302,600 | 410,711 | 420,768 | 455,786 | 35,018 | 8.3% |
| Repairs and maintenance | 231,123 | 392,837 | 394,565 | 375,380 | (19,185) | (4.9%) |
| Insurance | 276,064 | 280,854 | 282,330 | 287,093 | 4,763 | 1.7% |
| Workers' compensation insurance premiums | 124,820 | 226,559 | 130,268 | 175,612 | 45,344 | 34.8% |
| Management Fee - Team San Jose | 150,000 | 150,000 | 150,000 | 150,000 | 0 | 0.0% |
| Contracted services - City of San Jose | 117,403 | 83,939 | | | | |
| | | | | | | |
| TOTAL OPERATING EXPENSES | \$11,787,880 | \$12,643,221 | \$13,886,717 | \$14,968,013 | \$1,081,296 | 7.8% |
| TOTAL OPERATING REVENUES | 7,158,813 | 8,774,322 | 10,554,561 | 12,013,456 | 1,458,895 | 13.8% |
| OPERATING LOSS | \$4,629,067 | \$3,868,899 | \$3,332,156 | \$2,954,557 | (\$377,599) | (11.3%) |
| AGREEMENT NET LOSS TARGET | \$3,745,000 | \$1,966,000 | \$1,432,000 | \$975,000 | | |

Source: Auditor-generated using TSJ's audited financial statement for 2004 to 2008.

Overall, TSJ Met Its Economic Impact Performance Measure

The third performance measure, economic impact, requires TSJ to achieve specific attendee day figures for local/social visitors, out of town visitors, and exhibitors for each fiscal year of the Management Agreement. Exhibit 8 shows the Agreement performance measure targets as compared to the actual attendee numbers.

Exhibit 8: Yearly Comparison Of Management Agreement Attendance Targets To TSJ's Actual Attendance

| Fiscal Year | 2004-05 | | 2005-06 | | 2006-07 | | 2007-08 | |
|-----------------------------|----------------|-----------|----------------|-----------|----------------|-----------|----------------|-----------|
| | Target | Actual | Target | Actual | Target | Actual | Target | Actual |
| Local Visitors | 507,000 | 996,478 | 515,100 | 1,194,109 | 600,400 | 1,118,794 | 660,000 | 1,555,793 |
| Out of Town Visitors | 60,200 | 93,635 | 87,300 | 109,651 | 92,700 | 132,506 | 103,600 | 108,008 |
| Exhibitors | 10,000 | 31,591 | 18,500 | 33,914 | 19,700 | 21,029 | 22,000 | 15,948 |
| Total Attendees | 577,200 | 1,121,704 | 620,900 | 1,337,674 | 712,800 | 1,272,329 | 785,600 | 1,679,749 |

As shown above, TSJ met its economic impact targets for the past three years. However, in 2007-08, even though TSJ met the performance measure targets for local visitors and out of town visitors, it did not meet the target for exhibitors. According to the San Jose Convention and Visitor's Bureau, there were two primary reasons for the decline in exhibitor attendance last year. The first reason was due to the general economic slowdown. The second reason was in the second half of the year, many of the corporation and association groups/vendors started to either scale back their functions or send fewer exhibitors to attend their events. Among them were three of TSJ's highest-attendance events.

TSJ Met Its Customer Service Results Performance Measure

The fourth performance measure, customer service results, in the Management Agreement is stated as follows:

...The operator will create a standard survey instrument containing a series of product and service rating metrics including the following summary question, "Based on the services provided, please rate our overall performance."

Using 81% as the baseline, Operator will increase its customer service results by an additional 2% per year until Operator reaches a success rate of 91%.

In accordance with the Management Agreement, TSJ submits a monthly report to the Deputy City Manager. As part of this monthly report, TSJ provides the survey response rate and percentage of respondents who would book an event again at one of the convention and cultural facilities. For 2007-08, TSJ received a response rate of 18% for its customer service surveys. Among the event planners who responded, 98% rated either "Excellent" or "Very Good" on overall experience. Exhibit 9 below illustrates the 2007-08 customer service results.

Exhibit 9: 2004 To 2008 Customer Service Results

| Customer Service Results | 2004-05 | 2005-06 | 2006-07 | 2007-08 |
|--------------------------------------|------------------|----------------|----------------|----------------|
| Total Number of Events | 481 | 496 | 519 | 434 |
| Total Number of Surveys Returned | 46 | 90 | 117 | 78 |
| Response Rate | 10% | 18% | 23% | 18% |
| % Who Rated Excellent/Very Good/Good | 91% | 93% | 98% | 98% |
| Performance Measure Met? | N/A ⁵ | Yes | Yes | Yes |

Source: Auditor-generated.

⁵ Inconclusive due to insufficient number of surveys.

We should note that our 2004-05 audit found that TSJ did not collect sufficient customer survey information for us to assess if it met its customer service results performance measure target. However, as shown above, TSJ met the customer service results target for the past three years.

Management Agreement Termination And Compensation Deletion Provision

The Management Agreement contains both a termination and a compensation deletion provision in the event that TSJ fails to meet the performance measures listed in the Management Agreement. Specifically, the Management Agreement includes a provision that allows the City Council to terminate the Management Agreement, in whole or in part, if the Council determines TSJ has not met the performance measures stated in the Management Agreement.

The Management Agreement states that, *the City and TSJ (Operator) agree that if:*

- (a) Operator fails to achieve at least three of the four measures set forth in 4.8 or*
- (b) Operator fails to achieve at least 67% of any of measures (a), (b) or (c) set forth in Section 4.8 or fails to achieve the applicable annual percentage measure set forth in measure (d);*

then, City Council may terminate this Agreement within the time provided for in Section 6.1. The City Council's determination of whether Operator has met the performance measures and to what degree shall be at the City Council's sole discretion. Nothing in this section is intended to limit the City's discretion to terminate this Agreement for convenience or as otherwise provided for in this Agreement.

In addition, if in Year 4 (July 1, 2007 through June 30, 2008) or Year 5 (July 1, 2008 through June 30, 2009) of the term of the Management Agreement, TSJ fails to meet the performance measures set forth in Section 4.8, the City shall have the right to delete the fixed payment of \$150,000 from the preset management fee. The City may either eliminate the fee from the Operating Budget or require that the budgeted amount be expended for another purpose.

The City Has Elected To Award TSJ The Full Management Fee For 2007-08

While the Agreement states that *the City* has the right to delete the fixed payment of \$150,000 from the present management fee, it is unclear who has the authority to do so.

However, a memo from the City Manager's Office on January 21, 2009 states that in year four of the agreement, the senior city managers decided to award TSJ the Management Fee even though one of the four original performance measures as set forth in Section 4.8 of the agreement was not met. The reason given for this decision was that TSJ was able to produce substantial increases in revenue and TOT collections and as a result as a result increased the ending fund balance in the Fund 536 operating account. An additional consideration was that when the original performance measures were negotiated, operations were being transferred from the City's control to TSJ's control. Staff attempted to establish performance measures for the next five years, however staff believes those performance measures have proven to be unrealistic given extreme variability of the economy. Moving forward the next agreement will set performance measures annually as part of the budget process.

Therefore, we recommend that the City Manager:

Recommendation #1

Request that the City Council ratify the decision by the Administration to waive its right to delete the fixed payment of \$150,000 from the preset management fee for year four and, potentially, year five of the current Management Agreement. (Priority 1)

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Finding II Three Of The Six Open Audit Recommendations Are Implemented, Two Remain Partly Implemented And One Recommendation Is Not Implemented

The Office of the City Auditor has issued two previous audit reports for 2004 to 2007 to determine whether TSJ met the performance measures and other requirements specified in the Management Agreement.

The Office of the City Auditor prepares a semi-annual report on the status of outstanding audit recommendations. As of June 30, 2008, there were six outstanding audit recommendations remaining. The following provides a summary of the current status of these six recommendations (for period ending December 31, 2008). In total, three recommendations have been implemented, two remain partly implemented, and one has not been implemented.

Status Of Recommendations From The 2004-05 Annual Performance Audit Of Team San Jose, Inc.

The 2004-05 audit report included a total of 17 recommendations – 15 recommendations for Team San Jose (TSJ), one recommendation for the Administration, and one joint recommendation. As of June 30, 2008, five recommendations were partly implemented. The current status of these partly implemented recommendations is as follows:

| |
|--|
| <p>Recommendation #2 (TSJ) Develop a new Economic Impact Performance Measure Target based on factors such as historical data, the capacity of the Facilities, and the potential for future growth and amend the Management Agreement accordingly. This target should also include the actual number of room nights booked for events held in the Facilities. (Priority 3)</p> |
|--|

IMPLEMENTED – The Administration has negotiated a new Management Agreement for the period of July 1, 2009 to July 30, 2014. The new economic impact performance measure targets have been included in the new Management Agreement. The new economic impact performance measure includes total attendance (by local/out-of-town visitors, exhibitors) for events and hotel room nights. Components for this measure also include estimated economic impact (as measured of direct visitor spending) and a measure of the City’s return on investment. The new Agreement also includes a separate performance measure for Theater

Performance which is designed to measure both activation of the theaters and overall utilization of the theaters.

Recommendation #5 (Administration & TSJ) Develop a clearer and more specific Customer Service Results Performance Measure Target and amend the Management Agreement accordingly. (Priority 3)

IMPLEMENTED - The Administration has negotiated a new Management Agreement for the period of July 1, 2009 to July 30, 2014. The new customer service performance measure target has been included in the new Management Agreement.

Recommendation #14 (TSJ) Work with the Office of Equality Assurance and provide required documentation in order to fully meet the City's Living Wage and Prevailing Wage Policies as required in the Management Agreement. (Priority 3)

PARTLY IMPLEMENTED - As of August 2007, TSJ provided a listing of companies with which Team San Jose contracts and the services these companies provide to the Office of Equality Assurance. However, according to the Office of Equality Assurance, in order to determine if TSJ is in compliance with the City's Living Wage and Prevailing Wage Policies, additional information, such as the terms of these contracts, copies of the contracts and what TSJ does to ensure that the compliance has been achieved, is required. TSJ will also need to provide information regarding its employees. Additional coordination is needed between Team San Jose and the Office of Equality Assurance to ensure adequate information is being provided by TSJ for the analysis to be completed. The Office of Equality Assurance states that there has been no change in the status but intends to address this recommendation. A letter from the City Auditor was mailed on September 12, 2008 to Team San Jose and the Office of Equality Assurance outlining what needs to happen for this recommendation to be considered fully implemented.

Recommendation #15 (TSJ) Work with the City to amend the Management Agreement to allow TSJ to store and use any hazardous materials that are needed to operate and maintain the facilities. (Priority 3)

IMPLEMENTED - The new Management Agreement for the period of July 1, 2009 through June 30, 2014 includes updated language (including definitions) regarding Hazardous Materials as Section 19 of the Agreement.

Recommendation #16 (TSJ) Develop and implement a workplan to correct ADA noncompliant items and notify the City accordingly. (Priority 3)

PARTLY IMPLEMENTED – The Management Agreement between the City and TSJ states, “Operator shall be solely and fully responsible for complying with the Americans Disabilities Act of 1990 (ADA) in connection with: (a) any use of the facilities by guests or services provided by Operator to Customers; and (b) modifying its policies, practices, and procedures to comply with the ADA. Operator shall develop a work plan to correct or avoid any violations or non-compliance with the ADA. Operator shall perform an assessment of Facilities for ADA compliance and notify City of any compliance issues...”

Staff has completed the TSJ agreement negotiation process with the new management agreement for the period of July 1, 2009 through June 30, 2014. The Office of Economic Development staff resources will coordinate with various City departments and complete the review of TSJ’s ADA Assessment. In addition, as the expansion process moves forward, including the creation of a Convention Center Facilities District (CCFD), improvements and upgrades including ADA items will be identified and addressed depending on funding availability. The complete review of the assessment should be completed by June 2009.

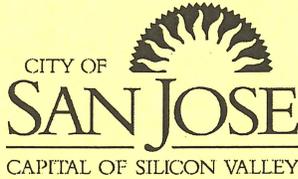
Status Of Recommendations From The 2005-06 And 2006-07 Annual Performance Audit Of Team San Jose, Inc.

The 2005-06 & 2006-07 audit report included one recommendation. As of December 31, 2008, that recommendation is not implemented. The current status is as follows:

Recommendation #1 (TSJ) Engage a team to perform a nation-wide executive search to hire a qualified individual with experience in the management of similar facilities as the Chief Executive Office of the Convention and Cultural Facilities in accordance with the Management Agreement. (Priority 3)

NOT IMPLEMENTED – It is the Administration’s interpretation that with the merger of the Team San Jose and Convention and Visitor’s Bureau’s Board of Directors that the City Council no longer wished to pursue a nation-wide executive search to hire an additional CEO. Through the new Management Agreement, the Administration will continue to monitor their performance.

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Memorandum

TO: Sharon Erickson
City Auditor

FROM: Paul Krutko
Chief Development Officer

SUBJECT: SEE BELOW

DATE: February 10, 2009

Approved

Date

2/10/09

SUBJECT: MANAGEMENT AGREEMENT TERMINATION AND COMPENSATION DELETION PROVISION

The Administration has reviewed the 2008-2009 Annual Performance Audit of Team San Jose, Inc. (TSJ) and is in general agreement with the recommendations identified in the report. This memorandum addresses one audit recommendation, number one, which was addressed to the Administration.

Recommendation #1: Request that the City Council ratify the decision by the Administration to waive its right to delete the fixed payment of \$150,000 from the present management fee for year four and, potentially, year five of the current Management Agreement. (Priority 1)

Agreed: The Administration is requesting the City Council ratify the decision to waive its right to delete the fixed payment of \$150,000 from the present management fee for both years four and five of the current Management Agreement.

BACKGROUND

In June 2004, the City Council approved a Management Agreement with TSJ for five years. The agreement included the provision as follows:

7 COMPENSATION

7.1 Management Fee

As total compensation to pay for Operator's services, City shall pay operator an annual Management Fee comprised of:

- (a) a Fixed Management Fee in the amount of One hundred and Fifty Thousand Dollars (\$150,000); plus
- (b) such amounts fixed in the approved Operating Budget as Executive Compensation.

Sharon Erickson, City Auditor

February 10, 2009

Subject: Management Agreement Termination and Compensation Deletion Provision

Page 2 of 2

The Fixed Management Fee shall be paid monthly in arrears in equal installments. The Executive Compensation shall be paid according to the provisions of Article 10.

7.2 Conditions of Payment in Years 4 and 5

If in Year 4 or 5 of the term of this Agreement Operator fails to meet the performance measures set forth in Section 4.8, City shall have the right to delete the fixed payment of \$150,000 from the Fixed Management Fee. City may eliminate the Fee from the Operation Budget or require that the budgeted amount be expanded for another purpose.

In year 4 of the agreement, FY 2007-08, the City paid TSJ the Management Fee even though not all of the original performance measures as set forth in Section 4.8 of the Management Agreement were not met. The reason for this was that it was not known until after entire fee was paid that the performance measures had not been met. In considering whether the fee should have been paid, the Administration decided that because TSJ was able to produce substantial increases in revenue and TOT collections and as a result increased the ending fund balance in the Fund 536 operating account, it was equitable to not seek to withhold the fee. An additional consideration was that when the original performance measures were negotiated, operations were being transferred from City control to TSJ's control. Staff attempted to establish performance measures for the next five years. Establishing performance measures in this way has proven to be unrealistic given the extreme variability in the economy.

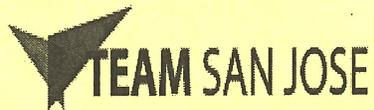
The Administration believes that the same logic would apply to year 5 of the contract, and also seeks Council's concurrence with its decision to not attempt to withhold the fee for that year as well.

Moving forward, the Administration has negotiated a new Management Agreement for the period of July 1, 2009 to July 30, 2014. New performance measure targets have been included in the new Management Agreement.



PAUL KRUTKO

Chief Development Officer



408 Almaden Boulevard | San Jose, California 95110 | www.sanjose.org

To: Honorable Mayor and City Council

From: Dan Fenton, CEO, Team San Jose

Date: February 10, 2009

Subject:

Team San Jose Response to the 2007-2008 Annual Performance Audit of Team San Jose, Inc.

Team San Jose appreciates the opportunity to respond to the Annual Performance Audit (“Audit”) completed by the Office of the City Auditor. The Audit reviews the FY 2007-2008 and demonstrates solid growth in revenue, a steady decrease in operating loss and continued success in serving our customers.

Since 2004, Team San Jose, Inc. and over 300 employees have served the City of San Jose and the local community through an innovative approach to customer service. Team San Jose, a non-profit corporation, has a direct impact on San Jose’s local economy and impacts business downtown through a unique local partnership between hoteliers, labor, the arts community, convention bureau, and Centerplate, our food and beverage provider.

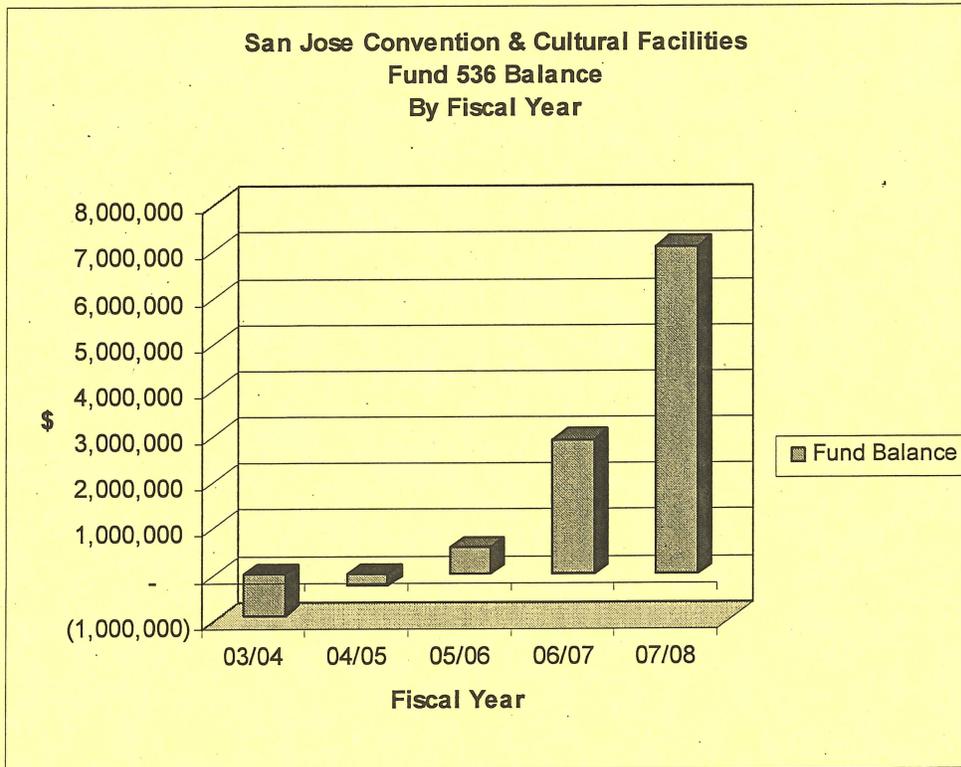
TSJ did not meet its net loss performance measure by \$1,979,557.

As stated in previous year audits, both the City and Team San Jose believe the performance measure targets should have been adjusted to the Management Agreement and budget to reflect unknown costs at the time the RFP for management of the convention center and cultural facilities was submitted. The overall gap between Team San Jose’s actual operating loss to the Management Agreement Performance targets would have been less as a result of these adjustments.

As a result of these adjustments not corrected, Team San Jose has not met its operating loss performance measure which was set almost five years ago. The approved Team San Jose, City Management Agreement for the next five years reflects a better approach to setting performance targets by establishing targets each year through the City’s budget process.

While the operating loss target was not met, Team San Jose has reduced the Convention and Cultural Facilities operating loss to 58.3% since the city’s last year of operation in 2004. In addition and most importantly, when Team San Jose took over the management of the Convention and Cultural Facilities, Fund 536 (the operating fund for the convention center and cultural facilities) had an operating balance of (negative) -\$873,776. At the end of FY2007-08,

the Fund balance for Fund 536 had grown to \$7,106,113, an increase of \$7,979,889. This balance is acting as a reserve to help safeguard the City's General Fund. This is especially important as the city continues to evaluate the potential expansion and renovation of the convention center.



NOT IMPLEMENTED

Response to Recommendation #1- Engage a team to perform a nation-wide executive search to hire a qualified individual with experience in the management of similar facilities as the CEO of the Convention and Cultural Facilities in accordance with the Management Agreement.

For the FY 2004-2005 Performance Audit, the report detailed that Team San Jose had met this contract section requirement. The report highlighted that the CEO fulfilled the contract requirement and that the CEO met regularly with the City Manager's Office/Contract Administrator.

Team San Jose's organizational structure has changed since signing the original management agreement in 2004. Team San Jose believes it has met this contract requirement through the current organizational structure of the company. In addition, as stated in the negotiated Management Agreement for 2009-2014, the merger of the San Jose Convention & Visitors Bureau and Team San Jose as of February 2009 makes this recommendation inapplicable.

The current CEO has over thirty years of sales, marketing, and operations experience to lead San Jose's convention center and cultural facilities. In addition to the current CEO's industry and management experience, the Director of Client Services and Director of Operations have over forty years of experience in the industry and the knowledge, experience and leadership to guide the organization and manage the facilities. Additionally, Team San Jose has two Building Superintendents with over thirty years of experience in facility management, dedicated to the operations of convention center and cultural facilities.

IMPLEMENTED

Response to Recommendation #2- Develop a new economic impact performance measure target based on factors such as historical data, the capacity of the Facilities, and the potential for future growth and amend the Management Agreement accordingly. This target should also include the actual number of room nights booked for events held in the Facilities.

In the negotiated 2009-2014 Management Agreement the performance measure focused on economic impact has been expanded to include: attendance, room nights booked, estimated economic impact and Return on Investment (ROI). The annual goals for these and all other performance measures will be established through the City's budgeting process each year and based on past performance and economic outlook.

The attendance goal will measure the overall draw of the facilities through the attraction of local, out-of-town visitors and exhibitors to events in the Convention and Cultural Facilities. The room night goal measures Team San Jose's effectiveness in generating room nights that drive Transient Occupancy Tax (TOT), thereby helping to fund both the General Fund and fund 536 (the operating fund of the convention center and cultural facilities). The estimated economic impact (EEI) goal measures the amount of spending generated in the City due to the activities at the Facilities.

Team San Jose is working with the Office of Economic Development (OED) on the development of a calculator for measuring the EEI of conventions and meetings. This new calculator is being developed by the same vendor that created OED's calculator for large public festival EEI and will run on a similar platform. Per Schedule 4.8(a)(3) of the new Contract agreement- both new calculators will be online in year two of the agreement. As a bridge-convention and meetings will utilize the industry's DMAI ExPact calculator for year one of the agreement.

IMPLEMENTED

Response to Recommendation #5- Develop a clearer more specific customer service results performance measure target and amend the management Agreement accordingly (Team San Jose & Administration)

Team San Jose regularly evaluates the customer service survey in order to determine new measures and necessities going forward. This allows the organization to continue to grow and respond to client needs. Through the new 2009-2014 Management Agreement, this measure will be reviewed annually through the City's budget process.

PARTIALLY IMPLEMENTED

Response to Recommendation #14- Work with the Office of Equality Assurance and provide required documentation in order to fully meet the City's Living Wage and Prevailing Wage Policies as required in the Management Agreement.

A list of contracts was sent over to the Office of Equality Assurance. In response to the City Auditors request, Team San Jose has designated a centralized person in charge of contracts and assuring Living and Prevailing Wage policies are being enforced. This person is to ensure that all contractors who do work in the facilities follow the City of San Jose polices. Team San Jose has copies of the City's certified payroll forms if the contractors do not have their own documentation. In addition all supervisors who have the ability to make service calls are also aware of the policy and inform any possible new vendor of the City and Prevailing wage policy.

The current process is such that upon submitting an invoice to Team San Jose for payment, the contractor will also provide list of proper pay rates for services. In addition, going forward Team San Jose is evaluating penalties to the contractors for when this does not occur.

IMPLEMENTED

Response to Recommendation #15- Team San Jose to work with the City to amend the Management Agreement to allow Team San Jose to store and use any hazardous materials that are needed to operate and maintain the facilities.

The use of hazardous materials is required to operate the convention and cultural facilities. Team San Jose communicated this to the previous Assistant City Manager who informed the City Council of the needed change in the existing contract. As a result, the City Council approved the storage and use of hazardous materials. Team San Jose currently has a Hazardous Materials Business Plan that has been filed with the San Jose Fire Department. This plan lists all chemicals and their locations within the convention center and cultural facilities managed by Team San Jose.

Through the new 2009-2014 Management Agreement, there are set requirements about handling hazardous materials and filing a plan with the San Jose Fire Department.

PARTIALLY IMPLETMENTED

Response to Recommendation #16- Develop and implement a work plan to correct ADA noncompliant items and notify the City accordingly.

Team San Jose agrees with Auditor's statement. Team San Jose completed an ADA assessment. Findings of the assessment were given to the Office of the City Manager in December 2008.

Next steps include the Office of the City Manager to hold a meeting with multiple city departments to collectively create a work plan to rectify any outstanding noncompliant items in the ADA assessment.

Conclusion

In conclusion, Team San Jose is proud of the accomplishments to date in the increase of revenue, decrease and managing of expenses, and support to our local community through our partnership with hotels, arts leadership, local labor, Centerplate, and the convention bureau.

Specific results include:

- Team San Jose has increase revenue by 52.5% since 2004.
- Team San Jose has reduced the operating loss of the McEnery Convention Center and Cultural Facilities to \$2,954,557 or 58.3% since the City's last year of operation in 2004 in which the operating loss was \$7,091,074.
- 98% of customers reported excellent or very good when rating their overall customer experience.
- For FY 2007-2008, over 1.6 million visitors visited San Jose, generating over \$200 million in economic impact.
- For Fiscal Year 2007-2008, 434 events were held at the Convention Center and cultural facilities.
- Hotel Average Occupancy for 2007-2008 is 62.08%, compared to the same period for 2006-2007 of 59.91%.

Team San Jose looks forward to continuing a strong partnership with the City as we work together make San Jose a great place to live, work, visit and play.

APPENDIX A

DEFINITIONS OF PRIORITY 1, 2, AND 3 AUDIT RECOMMENDATIONS

The City of San Jose's City Policy Manual (6.1.2) defines the classification scheme applicable to audit recommendations and the appropriate corrective actions as follows:

| Priority Class¹ | Description | Implementation Category | Implementation Action³ |
|-----------------------------------|---|--------------------------------|--|
| 1 | Fraud or serious violations are being committed, significant fiscal or equivalent non-fiscal losses are occurring. ² | Priority | Immediate |
| 2 | A potential for incurring significant fiscal or equivalent fiscal or equivalent non-fiscal losses exists. ² | Priority | Within 60 days |
| 3 | Operation or administrative process will be improved. | General | 60 days to one year |

¹ The City Auditor is responsible for assigning audit recommendation priority class numbers. A recommendation which clearly fits the description for more than one priority class shall be assigned the higher number.

² For an audit recommendation to be considered related to a significant fiscal loss, it will usually be necessary for an actual loss of \$50,000 or more to be involved or for a potential loss (including unrealized revenue increases) of \$100,000 to be involved. Equivalent non-fiscal losses would include, but not be limited to, omission or commission of acts by or on behalf of the City which would be likely to expose the City to adverse criticism in the eyes of its citizens.

³ The implementation time frame indicated for each priority class is intended as a guideline for establishing implementation target dates. While prioritizing recommendations is the responsibility of the City Auditor, determining implementation dates is the responsibility of the City Administration.