KPMG

HAWAII CONVENTION CENTER

Special-Purpose Financial Statements
and Supplementary Information

December 31, 2013

(With Independent Auditors' Report Thereon)

Submitted by

THE AUDITOR
STATE OF HAWAII

HAWAII CONVENTION CENTER

Table of Contents

KPMG

KPMG LLP
Suite 2100
1003 Bishop Street
Honolulu, HI 96813-6400

Independent Auditors' Report

The Auditor
State of Hawaii:

We have audited the accompanying special-purpose financial statements of the Hawaii Convention Center, which comprise the special-purpose balance sheet as of December 31, 2013, and the related special-purpose statement of revenues, expenses, and changes in net assets, and cash flows for the 18-month period then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these special-purpose financial statements in accordance with provisions of the management agreement between the Hawaii Tourism Authority and SMG; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of special-purpose financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these special-purpose financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the special-purpose financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the special-purpose financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the special-purpose 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 special-purpose 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 special-purpose 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 special-purpose financial statements referred to above present fairly, in all material respects, the financial position of the Hawaii Convention Center as of December 31, 2013, and the changes in its net assets and its cash flows for the 18-month period then ended, in accordance with the provisions of the management agreement between the Hawaii Tourism Authority and SMG as described in note 2 to the special-purpose financial statements.

Basis of Accounting

We draw attention to note 2 to the special-purpose financial statements, which describes the basis of accounting. The special-purpose financial statements are prepared pursuant to the provisions of the management agreement between the Hawaii Tourism Authority and SMG, which is a basis of accounting other than U.S. generally accepted accounting principles. Our opinion is not modified with respect to this matter.

Other Matters

Our audit was conducted for the purpose of forming an opinion on the special purpose financial statements that collectively comprise the Hawaii Convention Center's special-purpose financial statements. The supplementary information included in schedules 1 and 2 is presented for purposes of additional analysis and is not a required part of the special-purpose financial statements.

The supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the special-purpose financial statements. Such information has been subjected to the auditing procedures applied in the audit of the special purpose financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the special-purpose financial statements or to the special-purpose financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated in all material respects in relation to the special purpose financial statements taken as a whole.

Restriction on Use

This report is intended solely for the information and use of the Auditor, State of Hawaii and the boards of directors, and managements of the Hawaii Tourism Authority and SMG, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

Honolulu, Hawaii
July 8, 2015

HAWAII CONVENTION CENTER

Special-Purpose Balance Sheet

December 31, 2013

Assets

Current assets:		
Cash and cash equivalents	$	915,147
Due from Hawaii Tourism Authority		386,416
Accounts receivable, net of allowance for doubtful accounts		229,963
Inventories		141,591
Prepaid expenses		83,399
Deposits and other assets		47,386
Total current assets		1,803,902
Restricted cash		10,610,269
Total assets	$	12,414,171

Liabilities and Net Assets

Current liabilities:		
Accounts payable	$	894,140
Accrued compensation		85,715
Advance deposits		379,478
Other liabilities		2,496
Total current liabilities		1,361,829
Commitments and contingencies		
Unrestricted net assets		442,073
Restricted net assets		10,610,269
Total net assets		11,052,342
Total liabilities and net assets	$	12,414,171

See accompanying notes to special-purpose financial statements.

HAWAII CONVENTION CENTER

Special-Purpose Statement of Revenues, Expenses, and Changes in Net Assets

18-month period ended December 31, 2013

Operating revenues, net:		
Food and beverage	$	9,516,825
Rental income		2,242,295
Events		2,320,083
Other		96,861
Total operating revenues		14,176,064
Operating expenses:		
Cost of goods sold:		
Food and beverage		1,746,438
Other direct food and beverage costs		2,821,263
Total cost of goods sold		4,567,701
Other operating expenses:		
Salaries and wages		7,460,182
Utilities		3,699,085
Advertising and promotion		1,821,410
Payroll taxes and benefits		1,709,318
Contract labor		1,578,024
Repairs and maintenance		843,473
Travel and entertainment		800,439
Building operations		539,200
Management fee		410,000
Insurance		169,849
Professional fees		72,773
Community relations		59,742
Computer		32,913
Dues and subscriptions		28,802
Printing and stationery		26,782
General excise tax		26,461
Employee training		26,337
Office supplies		20,062
Postage		15,233
Rent		12,153
Miscellaneous		232,430
Total other operating expenses		19,584,668
Total operating expenses		24,152,369
Operating loss		(9,976,305)
Nonoperating revenues (expenses):		
Interest and dividend income		98,536
Net realized loss on investment		(128,849)
Total nonoperating expenses, net		(30,313)
Loss before contributions and remittance		(10,006,618)
Contributions from Hawaii Tourism Authority		21,652,612
Remittance to Hawaii Tourism Authority for completed events revenue		(14,303,722)
Change in net assets		(2,657,728)
Net assets at beginning of year		13,710,070
Net assets at end of year	$	11,052,342

See accompanying notes to special-purpose financial statements.

HAWAII CONVENTION CENTER

Special-Purpose Statement of Cash Flows

18-month period ended December 31, 2013

Cash flows from operating activities:		
Cash received from customers	$	14,207,806
Cash payments to suppliers of goods and services		(12,821,549)
Cash payments to employees		(9,514,320)
Net cash used in operating activities		(8,128,063)
Cash flows from noncapital financing activities:		
Contributions received from Hawaii Tourism Authority		21,489,775
Funds remitted to Hawaii Tourism Authority		(15,180,255)
Net cash provided by noncapital financing activities		6,309,520
Cash flows from investing activities:		
Interest and dividend income		98,536
Net realized loss on investment		(128,849)
Net cash used in investing activities		(30,313)
Net decrease in cash and cash equivalents		(1,848,856)
Cash and cash equivalents at beginning of year		2,764,003
Cash and cash equivalents at end of year	$	915,147
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	$	(9,976,305)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Bad debt expense		67,429
Decrease (increase) in operating assets:		
Accounts receivable		(133,654)
Inventories		10,739
Prepaid expenses		297,179
Deposits and other assets		1,619,713
Increase (decrease) in operating liabilities:		
Accounts payable		165,494
Accrued compensation		(344,820)
Advance deposits		165,396
Other liabilities		766
Total adjustments		1,848,242
Net cash used in operating activities	$	(8,128,063)

See accompanying notes to special-purpose financial statements.

(1) Organization

The Hawaii Convention Center (the Center), which opened to the general public in June 1998, is used for a variety of events, including conventions and trade shows, public shows, and spectator events. The Center offers approximately 350,000 square feet of rentable space, including 51 meeting rooms.

Effective July 1, 2000, the Hawaii Tourism Authority, State of Hawaii (the Authority), is responsible for the operation, management, and maintenance of the Center. The Authority is a discretely presented component unit of the State of Hawaii. The Center is reported as a special revenue fund of the Authority.

(2) Summary of Significant Accounting Policies

This summary of significant accounting policies is presented to assist readers in interpreting the special-purpose financial statements. These policies are considered essential and should be read in conjunction with the special-purpose financial statements.

(a) Financial Statement Presentation and Basis of Accounting

The special-purpose financial statements have been prepared pursuant to the provisions of the management agreement between the Authority and SMG (note 3) and are intended to present the financial position, changes in net assets, and cash flows of only that portion of the Authority that is attributable to the transactions of the Center based upon the accounting records maintained by SMG. The Center's operations are reported on an accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

These special-purpose financial statements are prepared in conformity with U.S. generally accepted accounting principles, except that the property, building, furniture, and equipment used in the Center's operations, and related depreciation expense, as well as debt used to finance such capital assets and the related interest expense, are not reflected on the accompanying special-purpose financial statements. Those assets, liabilities, and related expenses are reflected on the financial statements of the Authority.

(b) Operating Revenues and Expenses

The Center distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services in connection with the principal ongoing operations, management, and maintenance of the Center. Operating revenues include charges for services. Operating expenses include costs of services and administrative expenses. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

(c) Classification of Current and Noncurrent Assets and Liabilities

The Center considers assets to be current that can reasonably be expected, as part of its normal business operations, to be converted to cash and be available for liquidation of current liabilities within 12 months of the special-purpose balance sheet date. Liabilities that reasonably can be expected, as part of normal Center business operations, to be liquidated within 12 months of the special-purpose balance sheet date are considered to be current. All other assets and liabilities are considered to be noncurrent.

(Continued)

(d) Cash and Cash Equivalents

For purposes of the special-purpose statements of cash flows, the Center considers currency on hand, savings, demand deposits, and certificates of deposits purchased with an original maturity of three months or less to be cash and cash equivalents.

(e) Due from/to the Hawaii Tourism Authority

Due from the Authority represents expenses to be reimbursed by the Authority. Due to the Authority represents revenues on completed events and contributions that are required to be remitted to the Authority. These amounts are required to be accounted for separately and are not netted together for financial statement reporting purposes.

(f) Revenue Recognition

Operating revenues include charges for services, which are recognized when services are provided. The Center’s accounts receivable are due from companies in various industries. Credit is extended based on evaluation of the customer’s financial condition and collateral is not required. Accounts receivable are due within 30 days and are at stated amounts due from customers. The allowance for doubtful accounts is the Center’s best estimate of the amount of probable losses in the Center’s existing accounts receivable. Management determines the allowance based on a review of each specific customer accounts receivable balance. Accounts outstanding longer than 90 days are considered past due and delinquency letters are sent. The Center writes off accounts receivable when it determines they are uncollectible.

(g) Inventory

Inventory held by the Center comprises food and beverage items. Inventory is valued at the lower of cost (first-in, first-out method) or market.

(h) Discounts

Operating revenues are net of sales discounts amounting to $2,714,173 for the 18-month period ended December 31, 2013.

(i) Advertising Expenses

The Center expenses costs of advertising as incurred.

(j) Use of Estimates

The preparation of the special-purpose financial statements, in accordance with the terms of the management agreement, requires management of the Center to make estimates and assumptions that affect the amounts reported in the special-purpose financial statements and accompanying notes. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include the valuation of accounts receivable.

(3) Management Agreement

The Center is managed and operated by SMG under a management agreement dated June 28, 1996, as amended. The term of the original agreement was from June 28, 1996 to June 30, 2001 with two two-year option periods through June 30, 2005. In 2001, the first two-year option period was exercised by the Authority. Effective January 1, 2003, the Authority and SMG renegotiated the terms of the management agreement and extended the term of the agreement through June 30, 2006 with two five-year option periods through June 30, 2016. In June 2005, the Authority approved SMG’s option to extend the term of the agreement through June 30, 2011. In July 2011, the Authority extended the term of the agreement through June 30, 2013. In July 2012, the Authority extended the term of the agreement through December 31, 2013.

The management fee for the 18 months ended December 31, 2013 amounted to $350,000 plus an additional $60,000 bonus for exceeding certain performance measures.

SMG is on a cost-reimbursement contract whereby they are reimbursed by the Authority for costs incurred in operating the Center.

Effective January 1, 2014, the Authority contracted AEG, a private contractor, to manage and operate the Center. AEG also assumes responsibility for the Center's sales and marketing efforts. The Authority’s contract with AEG extends through December 31, 2018, with a termination option which may be exercised by the Authority in its sole discretion effective as of December 31, 2016.

(4) License and Food and Beverage Agreements

At December 31, 2013, various clients have contracts with the Center to reserve space for future conventions and events to be held at the Center. These clients signed license agreements with the Center, which require rental payments in advance. In addition, clients may be required to make payments for food and beverage in advance. At December 31, 2013, the Center estimates approximately $2,194,208 in future revenues, of which $379,478 was collected in advance and recorded as advance deposits on the special-purpose balance sheet.

(5) Sales and Marketing

In accordance with Act 253 of the 2002 Session Laws of Hawaii, the Center assumed responsibility for the advertisement and promotion of the Center effective January 1, 2003. In an effort to increase its sales and marketing efforts, the Center entered into an agreement with the Authority whereby the Authority agreed to provide additional funding to the Center. The term on the agreement is from January 1, 2003 through June 30, 2006 with two five-year option periods through June 30, 2016. In June 2005, the Authority approved the Center’s option to extend the terms of the agreement through June 2011. In July 2011, the Authority extended the term of the agreement through June 2012. In July 2012, the Authority extended the term of the agreement through December 2013. During the 18 months ended December 31, 2013, the Center received $21,652,612 from the Authority, of which approximately $4,397,748 was required to be spent on sales and marketing. During the 18 months ended December 31, 2013, the Center’s sales and marketing expenses were $5,437,822. In accordance with the agreement between the Authority and the Center, the Center is not required to remit the unspent funds back to the Authority provided that the unspent funds be used for sales and marketing in subsequent years and approved by the Authority's board of directors. These sales and marketing costs are included as operating expenses in the Center's special-purpose statement of revenues, expenses, and changes in net assets for the 18 months ended December 31, 2013.

(6) Capital Improvements

Disbursements for property, building, and equipment are recorded as a reduction of contributions from the Authority since such capital assets are not recorded on the Center's special-purpose balance sheet (note 2). Disbursements for property, building, and equipment were $1,175,515 as of December 31, 2013.

In 2013, the Center did not receive funds from the Authority to be used for emergency capital improvements, repair or maintenance purchases, and on various capital improvement projects. The Center is not required to remit unspent funds back to the Authority provided that the unspent funds be used for capital improvements. The Center had $10,610,269 in unspent funds at December 31, 2013. As of December 31, 2013, the Center had remaining commitments relating to the acquisition of capital assets of $249,843.

(7) Contingencies

The Center is involved in various other claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Center's assets and liabilities, results of operations, or liquidity.

(8) Pension Plan

The Center has a defined-contribution pension plan for all employees meeting service, age, and employment status requirements. The Center contributes an amount equal to 40% on up to the first 5% of the employee's contributions to be determined annually based on a percentage of a participating employee's annual salary at the end of each calendar year. Contributions to the plan amounted to $103,105 during the 18 months ended December 31, 2013.

SUPPLEMENTARY INFORMATION

Schedule 1

HAWAII CONVENTION CENTER

Schedule of Changes in Net Assets

18-month period ended December 31, 2013

	Contributions from Hawaii Tourism Authority	Accumulated deficit	Total
Balance at June 30, 2011	$ 105,127,963	(90,674,146)	14,453,817
Loss before contributions and funds remitted	—	(8,248,896)	(8,248,896)
Contributions from Hawaii Tourism Authority	17,019,923	—	17,019,923
Remittance to Hawaii Tourism Authority for for completed events revenue	(9,514,774)	—	(9,514,774)
Balance at June 30, 2012	112,633,112	(98,923,042)	13,710,070
Loss before contributions and funds remitted	—	(10,006,618)	(10,006,618)
Contributions from Hawaii Tourism Authority	21,652,612	—	21,652,612
Remittance to Hawaii Tourism Authority for completed events revenue	(14,303,722)	—	(14,303,722)
Balance at December 31, 2013	$ 119,982,002	(108,929,660)	11,052,342

See accompanying independent auditors’ report.

Schedule 2

HAWAII CONVENTION CENTER

Schedule of Revenues, Expenses, and Changes in Net Assets

18-month period ended December 31, 2013

	Convention center operations	Sales and marketing	Total
Operating revenues, net:			
Food and beverage	$ 9,516,825	—	9,516,825
Rental income	2,242,295	—	2,242,295
Events	2,320,083	—	2,320,083
Other	96,861	—	96,861
Total operating revenues	14,176,064	—	14,176,064
Cost of goods sold:			
Food and beverage	1,746,438	—	1,746,438
Other direct food and beverage costs	2,821,263	—	2,821,263
Total cost of goods sold	4,567,701	—	4,567,701
Gross profit	9,608,363	—	9,608,363
Other operating expenses:			
Salaries and wages	5,508,284	1,951,898	7,460,182
Utilities	3,655,847	43,238	3,699,085
Advertising and promotion	10,161	1,811,249	1,821,410
Payroll taxes and benefits	1,362,532	346,786	1,709,318
Contract labor	1,273,956	304,068	1,578,024
Repairs and maintenance	810,489	32,984	843,473
Travel and entertainment	15,642	784,797	800,439
Building operations	539,200	—	539,200
Management fee	410,000	—	410,000
Insurance	169,849	—	169,849
Professional fees	59,648	13,125	72,773
Community relations	—	59,742	59,742
Computer	23,687	9,226	32,913
Dues and subscriptions	9,500	19,302	28,802
Printing and stationery	1,202	25,580	26,782
General excise tax	23,020	3,441	26,461
Employee training	25,608	729	26,337
Office supplies	17,258	2,804	20,062
Postage	5,161	10,072	15,233
Rent	—	12,153	12,153
Miscellaneous	225,802	6,628	232,430
Total other operating expenses	14,146,846	5,437,822	19,584,668
Operating loss	(4,538,483)	(5,437,822)	(9,976,305)
Nonoperating revenues:			
Interest and dividend income	97,167	1,369	98,536
Net realized loss on investment	(128,849)	—	(128,849)
Total nonoperating expenses, net	(31,682)	1,369	(30,313)
Loss before contributions and remittance	(4,570,165)	(5,436,453)	(10,006,618)
Contributions from Hawaii Tourism Authority	17,254,864	4,397,748	21,652,612
Remittance to Hawaii Tourism Authority for completed events revenue	(14,303,722)	—	(14,303,722)
Change in net assets	$ (1,619,023)	(1,038,705)	(2,657,728)

See accompanying independent auditors' report.