

**Internal Audit of
Port of Richmond**



for

City of Richmond

June 28, 2011



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City of Richmond

Internal Audit of the Port of Richmond

I. PURPOSE OF REVIEW

The Port of Richmond (the “Port”) is a department of the City of Richmond (the “City”). This internal audit of Port activities was conducted to review the financial operations, efficiency, effectiveness and organizational structure of the Port and to provide City management with recommendations for improvement.

II. SCOPE AND APPROACH

The procedures that we performed during the internal audit were:

- Held discussions with City management to:
 - Finalize scope of internal audit
 - Obtain financial statements, budget and other relevant documents
 - Agree on timing and communication protocols
 - Schedule interviews
- Gathered and read budget, policies and procedures, organization charts, financial statements, performance measures and other relevant documents
- Prepared detailed work plan
- Interviewed employees and management of the Port of Richmond. Interviews focused on:
 - Mission and goals
 - Rate setting, billing and collecting procedures
 - Current business process workflow, practices and procedures
 - Environmental and other risks
 - Capital project plans and related funding
 - Capabilities of financial software
 - Historical problems and concerns
- Gathered “best practices” data and analyzed operations, work flow and record keeping and developed recommendations

- Prepared draft report containing a discussion of tariff fees, tenant leases and rental revenue, financial statements and forecasts, summary of internal controls, summary of city financing, capital projects and funding, work plan, findings, and recommendations for improvement
- Reviewed findings and recommendations with the Port Director to assure facts are correct, and that recommendations are understood and implementable
- Revised report based on feedback and presented final report to City management

III. OVERVIEW OF OPERATIONS

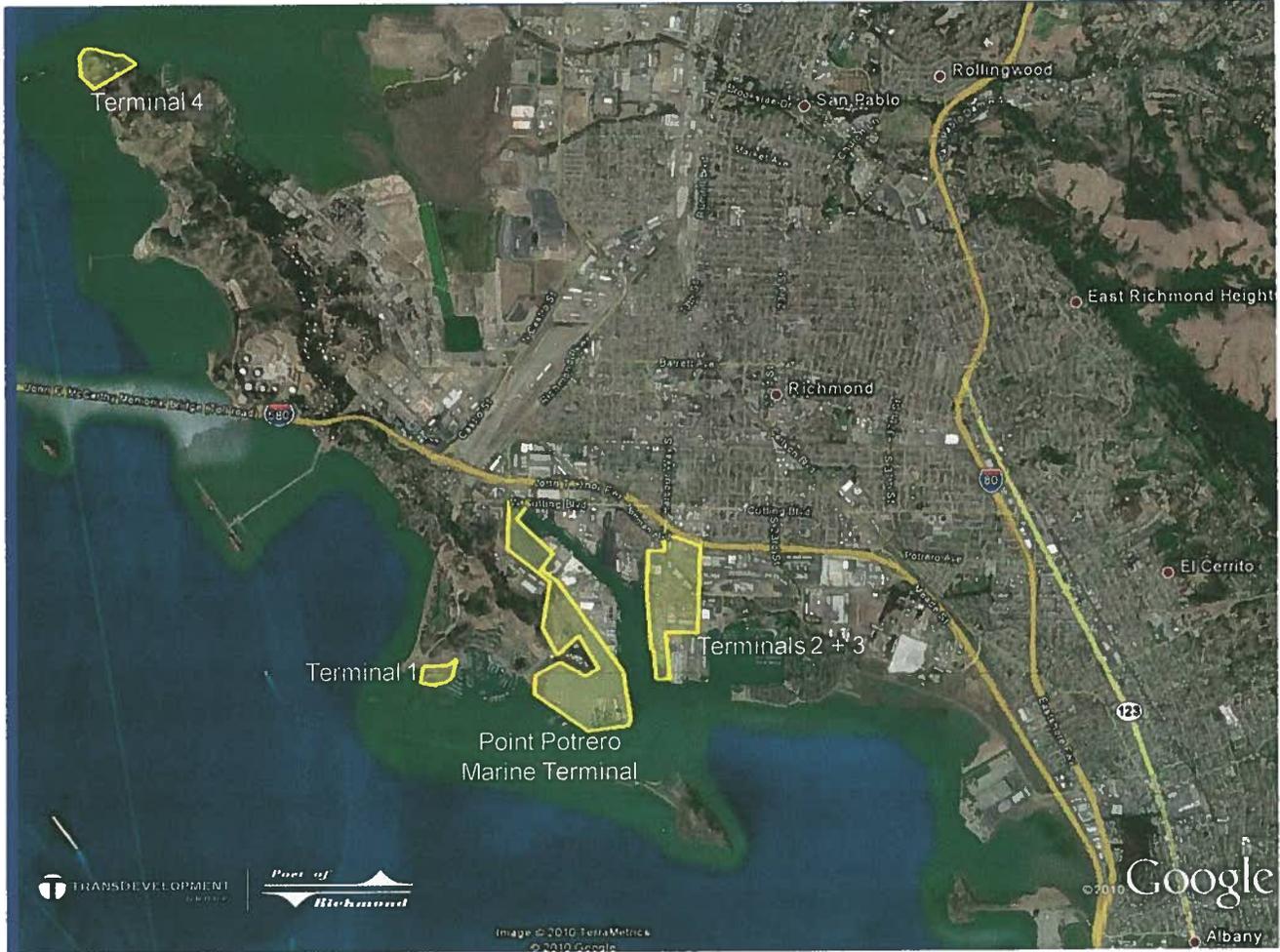
Mission

The Port is responsible for developing, marketing, leasing, operating and maintaining all City-owned marine terminals to obtain the maximum financial benefit to the City. Port revenue is generated through the application of the Port Tariff and property lease agreements, which is used to fund operations, maintenance, capital improvements and debt service.

Property Description

Richmond has 32 miles of shoreline along the northern and eastern reaches of San Francisco Bay. There are five city-owned terminals. These tenant-operated terminals handle a variety of liquid and dry bulk commodities, automobiles and diversified cargo. There are ten privately-owned terminals in the vicinity of the Port's operations that handle bulk liquid, dry bulk materials, metals, and bulk cargo; however the Port has no operational or oversight responsibilities for them. The Port has approximately 200 acres of land and 400,000 square feet of building space, of which approximately 40 acres and 180,000 square feet of building space is not currently rented. A brief description of each terminal and a map of the terminals follows:

- **Terminal 1** – 14 acres of land and a warehouse in need of repair. Not currently rented. The Redevelopment Agency is leading a request for proposal process to develop.
- **Terminal 2** – 8 acres of land and two warehouses totaling 140,000 square feet used for the storage and distribution of liquid bulk. The terminal is currently rented to a private business.
- **Terminal 3** - 20 acres of land and a warehouse of 80,000 square feet used for the import, storage and distribution of bulk cargo and containers. The terminal is currently not rented but the second and third floors serves as the Port's Administrative Office.
- **Terminal 4** – 37 acres of land and a warehouse of 12,000 square feet used for trucking and storage.
- **Point Potrero Marine Terminal** –130 acres of land, four graving docks, two finger piers and two warehouses totaling 170,000 square feet used for import, storage and distribution of autos, dry and liquid bulk, The terminal is currently rented to seven private businesses, two nonprofit organizations and one federal agency.



Financial Summaries and Forecast

Following are Port operating results from the City’s audited annual financial report for each of the previous four years (on the accrual basis of accounting):

| | <i>2006-07</i> | <i>2007-08</i> | <i>2008-09</i> | <i>2009-10</i> |
|--|------------------|------------------|------------------|------------------|
| OPERATING REVENUES | | | | |
| Leases | \$5,206,410 | \$5,765,173 | \$4,893,730 | \$3,867,981 |
| Layberth | 186,216 | 170,331 | | |
| Other | | (35,378) | 202,110 | 14,172 |
| Total Operating Revenues (Note 1) | 5,392,626 | 5,900,126 | 5,095,840 | 3,882,153 |
| OPERATING EXPENSES | | | | |
| Salaries and wages | 735,394 | 837,443 | 1,008,522 | 1,076,538 |
| General and administration | 1,345,398 | 2,129,592 | 2,284,256 | 1,483,175 |

| | | | | |
|--|----------------------|--------------------|---------------------|----------------------|
| Maintenance | 22,075 | 50,661 | 187,023 | 368,404 |
| Depreciation | 908,726 | 919,326 | 886,392 | 1,393,558 |
| Other | 3,440 | 7,037 | 11,312 | 79,338 |
| Total Operating Expenses (Note 2) | 3,015,033 | 3,944,059 | 4,377,505 | 4,401,013 |
| Operating Income (Loss) | 2,377,593 | 1,956,067 | 718,335 | (518,860) |
| NONOPERATING REVENUES (EXPENSES) | | | | |
| Gain (loss) on retirement of capital assets | 41,000 | (60,272) | | (452,495) |
| Interest income | 187,774 | 161,534 | 146,422 | (17,096) |
| Grants | | 2,782,673 | 50,027 | 25,000 |
| Interest expense | (675,700) | (585,458) | (361,764) | (3,757,708) |
| Total Nonoperating Revenues (Expenses) (Note 3) | (446,926) | 2,298,477 | (165,315) | (4,202,299) |
| Income (Loss) Before Transfers | 1,930,667 | 4,254,544 | 553,020 | (4,721,159) |
| Transfers In (Note 4) | 1,047,225 | 1,863,750 | | |
| Transfers Out | | (156,870) | (7,608) | |
| Changes in Net Assets | 2,977,892 | 5,961,424 | 545,412 | (4,721,159) |
| Beginning Net Assets | (5,632,589) | (2,654,697) | 3,306,727 | 3,489,111 |
| Ending Net Assets (Note 5) | \$(2,654,697) | \$3,306,727 | \$ 3,852,139 | \$(1,232,048) |

Notes:

- (1) Operating revenues in fiscal year 2009-10 declined primarily from Auto Warehousing due to construction of Honda improvements.
- (2) Operating expenses increased from fiscal year 2006-07 primarily as a result of two additional Port employees and additional depreciation and maintenance related to the new Honda facilities.
- (3) Non-operating revenues (expenses) – The large grant revenue in fiscal year 2007-08 was for security cameras and the large interest expense in fiscal year 2009-10 was debt service on the Honda debt.
- (4) Transfers in – Fiscal year 2006-07 represents transfer in of proceeds from Port Terminal Lease Revenue Bond Fund to pay for capital improvements. Fiscal year 2007-08 represents transfer in for closure of certain Port funds and consolidation into a single fund.
- (5) Ending net assets for fiscal year 2008-09 not equal beginning net assets for fiscal year 2009-10 because of the City's implementation of a new accounting standard regarding derivative investments.

Below is the Port's financial forecast for the current and four subsequent years. Since the forecast is shown on a cash basis of accounting, it is not consistent with the historical results shown in the table above (e.g., it includes capital outlay expenditures instead of depreciation expense and includes contribution from bond proceeds as a transfer in).

| | <i>Projected Actual 2010-11</i> | <i>Budget 2011-12</i> | <i>Forecast 2012-13</i> | <i>Forecast 2013-14</i> | <i>Forecast 2014-15</i> |
|---|---|---------------------------|-----------------------------|-----------------------------|-----------------------------|
| REVENUES | | | | | |
| Leases | \$ 6,567,997 | \$ 8,176,447 | \$8,335,753 | \$8,493,725 | \$8,814,663 |
| Grants (Note 1) | 400,000 | 11,600,000 | | | |
| Other Revenues | 28,446 | 50,000 | 50,000 | 50,000 | 50,000 |
| Total Revenues | 6,996,443 | 19,826,447 | 8,385,753 | 8,543,725 | 8,864,663 |
| EXPENDITURES | | | | | |
| Salaries & Benefits | 918,137 | 965,375 | 997,806 | 1,041,700 | 1,087,592 |
| Professional & Admin | 150,000 | 1,188,475 | 1,247,899 | 1,310,294 | 1,403,539 |
| Other Operating | 54,200 | 49,300 | 51,765 | 54,353 | 57,071 |
| Equipment & Contract Services | 45,000 | 38,500 | 40,425 | 42,446 | 44,569 |
| Utilities | 201,700 | 237,100 | 248,955 | 261,403 | 274,473 |
| Provision for Insurance | 24,000 | 30,000 | 31,500 | 33,075 | 34,729 |
| Cost Pool | 942,802 | 883,269 | 942,802 | 942,802 | 942,802 |
| Capital Outlay (Note 1) | 8,758,035 | 13,480,000 | 1,000,000 | | |
| Debt Service | 3,855,443 | 3,868,055 | 3,868,055 | 6,203,862 | 6,092,854 |
| Total Expenditures | 14,949,317 | 20,740,074 | 8,429,207 | 9,889,935 | 9,937,629 |
| OTHER FINANCING SOURCES (USES) | | | | | |
| Contribs from Bond Proceeds (Note 2) | 9,405,465 | 1,108,053 | | | |
| Operating Transfer In (Note 3) | | 750,000 | | | |
| Operating Transfers Out (Note 3) | | (250,000) | (150,000) | (150,000) | (150,000) |
| Total Other Financing Sources (Uses) | 9,405,465 | 1,608,053 | (150,000) | (150,000) | (150,000) |
| Operating Surplus (Deficit) | 1,452,591 | 694,426 | (193,454) | (1,496,210) | (1,222,966) |
| Beginning Balance | 457,607 | 1,910,198 | 2,604,624 | 2,411,170 | 914,960 |
| Ending Balance | \$1,910,198 | \$2,604,624 | \$2,411,170 | \$914,960 | \$(308,006) |

Notes:

- (1) Grants revenue and capital outlay expenditures for fiscal year 2011-12 are both large as a result of grant funding received to construct facility improvements as discussed on page 11.
- (2) Represents use of 2009 lease revenue bond proceeds for Honda improvements.
- (3) Represents \$750,000 operating transfer from City General Fund to finance Subaru improvements, and related repayments to the General Fund of \$150,000 per year. \$100,000 transfer out in fiscal year 2011-12 is for Riggers Loft project.

Fiscal years 20123-13 through 2014-15 forecast an aggregate operating deficit of nearly \$3 million. Port management believes this forecast is conservative because it (i) assumes no new

tenants even though the Port is actively pursuing new business from China and (ii) excludes significant expenditure on capital projects and potential grant funding.

Tariff and Fees

Amounts charged to tenants for dockage, wharfage and service charges are recommended by the Port Director and approved by both the City Council and the California Association of Port Authorities. The rates are based on the type of commodity being shipped. The tariff for the Port of Richmond has not been revised since April 2007 and prior to that had not changed since December 1999. Following are the most used rates from the Port’s tariff:

- Dockage - based on the length of the ship times tariff rate times the number of days docked. Example rates are:

| | |
|------------|---|
| 30 meters | \$84 for 1 st 24-hour period |
| 390 meters | \$11,950 for 1 st 24-hour period |

- Wharfage:
 - Non-containerized cargo vessel through pipeline \$1.50 per metric ton

 - Automobiles, pleasure or passenger, including pick-up trucks or chassis, not exceeding 10 passengers per vehicle \$23.10 each

- Service and Facility Charges - Liquids in bulk from/to vessel or barge \$1.50 per metric ton

Summary of Tenant Leases

Following is a summary of leases for fiscal year 2009-10:

| Tenant | Location | Lease Term | | Revenue FY 2009-10 | Annual Rent Increase | Security Deposit per Lease |
|-----------------------------|------------|------------|------------|---------------------------|-------------------------|----------------------------------|
| | | Begin | End | | | |
| <u>Space Rental</u> | | | | | | |
| Aloha Moving | PPMT | 6/4/2003 | na | \$ 20,408 | none | \$1,800 |
| Foss Maritime | PPMT | 1/1/2007 | 1/1/2012 | 284,940 | 4% | 9,000 |
| General Services Admin | PPMT | 3/1/2006 | 2/28/2011 | 65,000 | none | none |
| Honda of El Cerrito | PPMT | 12/1/2007 | 11/30/2009 | 78,000 | 5% | 6,500 |
| Crowley Maritime | PPMT | 10/24/2002 | na | 17,724 | none | 1,000 |
| California Oils | Terminal 2 | 1/1/1991 | 6/30/2016 | 232,631 | 4% | none |
| Auto Warehousing | PPMT | 5/1/2004 | 5/1/2014 | 1,082,163 | none | none |
| Marine Spill Response | PPMT | 6/30/2003 | 6/13/2013 | 270,265 | 3% | none |
| Nextel | Terminal 3 | 12/31/1998 | 12/31/2013 | 24,542 | 5% | none |
| Oscar Niemeth | PPMT | 3/6/2006 | na | 43,549 | none | none |
| Maas Boat Co. | PPMT | 1/1/1995 | na | 23,063 | 5% | 1,636 |
| Pio Trucking | Terminal 4 | 6/1/2010 | 5/31/2011 | 20,250 | none | 4,500 |
| Richmond Museum | PPMT | 9/20/1998 | 6/20/1999 | - | na | none |
| <u>Dockage Fees</u> | | | | | | |
| ISS Marine Srvc Inchcape | Vessel | | | 430,981 | | |
| K-Sea transportation LLC | Vessel | | | 16,288 | | |
| Matson Navigation | Vessel | | | 194,521 | | |
| Northland Nautical | Vessel | | | 819 | | |
| Olympic Tug and Barge | Vessel | | | 7,454 | | |
| Red Oak Victory | Vessel | | | 7,885 | | |
| Sause Bros | Vessel | | | 93,224 | | |
| Starlight Maria | Vessel | | | 795 | | |
| Stevedoria Services | Vessel | | | 469,200 | | |
| Translogix (AWC storage) | Vessel | | | 16,276 | | |
| Wilhelmser Ship Service | Vessel | | | 33,605 | | |
| Patriot Environmental Svces | Vessel | | | 10,000 | | |
| Norton Lilly | Vessel | | | 26,451 | | |
| K line America Inc. | Vessel | | | <u>2,585</u> | | |
| | | | | <u>\$3,472,619</u> | | |

Summary of Internal Controls

Billing Procedures

The Port bills and collects three types of revenue: 1) monthly rent; 2) layberth or docking fees; and 3) the Auto Warehousing contract.

- **Monthly Rent** - Bills are prepared by the Financial Manager. The monthly rent is for the rental of the actual space a tenant uses. There are currently eleven tenants that pay monthly rentals. The Financial Manager prepares the invoices for the monthly rentals. The following procedures are followed:
 - Monthly invoices are entered into MUNIS
 - Invoice batches are printed, checked for accuracy and emailed to the City's Finance Department (Finance)
 - All backup is scanned and sent to Finance
 - Finance approves and posts the batch in MUNIS
 - Finance mails the invoices to the tenants and also sends the Financial Manager a copy
 - All payments are mailed directly to finance. Finance does not notify the Port when the cash is actually received but sends a monthly statement to the Financial Manager who mails to the tenants
 - The Financial Manager prepares a receivables aging report which is downloaded from MUNIS

- **Layberth or Docking Fees** - Currently the Port has two major tenants that pay for docking and wharfage: California Oils and Honda. Each one uses a vessel agent that submits a Vessel Activity Report, which lists the ship name, arrival dates, number of units and total wharfage, to the Port's Financial Manager. The information is verified by the Financial Manager by comparing to the Port's Vessel Schedule Report. The vessel agent is billed for wharfage and dockage based on the tariff rates and are entered in MUNIS as described above.

- **Auto Warehousing Contract** - The agreement with Auto Warehousing Company (AWC) requires the Port to refund to AWC 25% of the total wharfage earned for the month. Each month a Vessel Schedule Report and a Honda Revenue Earned Report are submitted by AWC to the Port's Financial Manager. The Honda Revenue Earned Report contains the revenue earned by each vessel that arrived at the Port, and the wharfage, surcharge, services, storage and facility charges per unit. The Financial Manager compares the volume information on the Vessel Schedule Report to the amounts billed on the Honda Earned Revenue Report. AWC is billed based on the tariff rates and are entered in MUNIS as described above.

Purchasing and Cash Disbursement Procedures

The Port uses a purchasing checklist (P3 form) that is required for all purchases of goods and services. The P3 form is completed by the person initiating the transaction. The P3 form is entered in MUNIS by the Financial Manager and is approved by the Port Director. Once the P3

form is approved in MUNIS, a purchase requisition is entered, approved and a purchase order is created for all contracts exceeding \$10,000. The person who initiated the transaction mails the purchase order to the vendor.

Invoices are submitted by vendors directly to Finance. Finance emails the Port the invoices to approve for payment. The Financial Manager prints the invoices and obtains the signature of either the Port Director or the Development Project Manager for approval. The approved invoice is scanned as a "goods received" document and is entered into MUNIS. The Financial Manager emails Finance to notify them to pay the invoice.

Three Port employees have Calcards for purchases with up to a maximum of \$3,000 per day. The Port \$500 petty cash fund for small purchases.

Payroll Procedures

The Port's payroll is processed by the Operations Administrator. The Port is included in the City's payroll process which is on a semi-monthly basis. The Port has five employees.

On an annual basis, Finance sends the Port a schedule of timesheet due dates. A blank timesheet is also sent and copies are made for each employee for each pay period. Staff signs their timesheets and are approved by the Port Director. The Port Director's timesheet is approved by the City Manager.

Staff requests for time off are handled via the intranet by using an Employee Self Service Request Form (ESS). The ESS form goes to the Port Director for approval and the request is sent back to the employee. On the timesheet due date, the ESS form is printed and attached to the timesheet. All timesheets and ESS forms are then forwarded to City Payroll for processing.

Accounting and Reporting Procedures

Journal entries are processed using the City's standard journal entry procedures. The Financial Manager prepares all journal entries using the journal entry form and enters into MUNIS. MUNIS automatically assigns a journal entry number. All backup for the entry is scanned and sent to Finance for review, approval and posting. Finance sends the journal back to the Financial Manager after it has been posted in MUNIS.

Each month a budget vs. actual variance report is prepared by the Port and is due to Finance by the 10th of the following month. The variance report is prepared by the Financial Manager with information downloaded from MUNIS. The reports are reviewed and discussed in staff meetings at the Port. Each quarter the Port prepares a performance measures report which analyzes the activities of the Administration and Capital Improvement Projects divisions. The Port also prepares a midyear review report and a five-year projection report.

Budgeting Procedures

The Financial Manager coordinates the budget preparation process and all staff are involved in providing information. A budget narrative is prepared to accompany the budget amounts. The budget is reviewed by the Executive Director and then uploaded to MUNIS for review by

Finance. At the end of each month, the Financial Manager prepares a budget vs. actual variance report that is reviewed by Port management.

Staffing

The Port has the following staffing as of March 31, 2011:

- Port Director – Jim Matzorkis
- Port Administrator – Open
- Development Project Manager II – Michael Williams
- Operations Administrator – Janie Singleton
- Financial Manager – Delmy Cuellar
- Maintenance Lead Worker – Tim Goins

City Financing

Loan from City

On May 17, 2006, the City and Port entered into a promissory note effective June 30, 2005 in the amount of \$17,139,855. The note bore no interest and required repayments of \$6.3 million on or about July 1, 2006, \$700,000 for 2008-09 and \$2,027,971 for each fiscal year thereafter until the note was fully repaid during fiscal year 2013-14. The note states that the amount owed by the Port is for “Port terminal leases and other Port projects financed by the General Fund”.

On May 24, 2007, the City and Port entered into a promissory note in the same amount of \$17,139,855. The note requires principal repayments of \$50,000 for fiscal year 2006-07 and fiscal year 2007-08, \$6,350,000 for fiscal year 2008-09, \$2,000,000 for each of the fiscal years 2009-10 through 2013-14, and \$689,855 for fiscal year 2014-15. The repayment schedule attached to the note begins charging interest for fiscal year 2009-10 at the interest rate equivalent to the three year LAIF of the outstanding principal amount. The repayment schedule assumed that the \$6,350,000 principal payment scheduled for fiscal year 2008-09 would be made, however terminal 1 was not sold as expected so this payment was not made.

Following is actual activity related to the City loan per the Port’s accounting records since its inception:

| | |
|---------------------|---|
| \$17,139,855 | Owed to City at June 30, 2006 per promissory note |
| (50,000) | Repayment May 2007 |
| (50,000) | Repayment June 2008 |
| <u>397,525</u> | Interest accrued at June 30, 2010 |
| <u>\$17,437,380</u> | Owed to City at June 30, 2010 |

Indirect Cost Allocations

The Port pays the City’s General Fund \$942,802 per year for its share of the City’s indirect costs. We understand that the City has conducted a new cost allocation study during fiscal year 2010-11 and the Port’s share of allocated costs will decline to \$836,017 per year. Specifically, the allocated costs for fiscal year 2010-11 are:

| | |
|-------------------------------|------------------|
| Maintenance | \$ 37,450 |
| Information technology | 27,385 |
| General liability insurance | 25,527 |
| Communications | 16,388 |
| PC support | 5,265 |
| Financial software | 42,453 |
| Geographic information system | 1,144 |
| Administration | <u>787,190</u> |
| Total | <u>\$942,802</u> |

Administration charges are allocations of costs related to building usage, City Council and Mayor, City Manager, Finance, Human Resources, City Clerk and City Attorney.

Capital Projects and Funding

Following is a schedule showing the Port's approved capital projects, and the related financing:

| <i>Project Description</i> | <i>Expenditures</i> | | <i>Financing Sources</i> |
|--------------------------------------|---------------------|---------------------|--------------------------|
| | <i>3/31/11 LTD</i> | <i>Budget</i> | |
| Bay Trail Shipyard No. 3 | | \$ 692,000 | Grant |
| Berth Dredging | | 1,058,844 | Unfunded |
| Fiber Optic Network | | 4,310,504 | Grant |
| Honda Port of Entry at PPMT | \$3,220,162 | 5,771,329 | Debt Proceeds |
| Integrated Video Surveillance System | | 3,018,027 | Grant |
| Lighting Improvements at PPMT | | 2,650,000 | Grant |
| Marina Dredging | | 2,100,000 | City |
| Port Rail Corridor Facilities | 1,904,917 | 2,295,211 | Debt Proceeds |
| Railroad Improvements Quiet Zones | 190,088 | 1,000,000 | Port Cash |
| Subaru Building 4 Rehab | | 750,000 | City |
| Terminal 2 Timber Wharf Replacement | | 1,000,000 | Unfunded |
| Terminal 3 Office Building Upgrade | <u>154,561</u> | <u>3,787,889</u> | Grant |
| Total | <u>\$5,469,728</u> | <u>\$28,433,804</u> | |

The financing sources listed above are:

- Grant – represents grants awarded to Port as discussed on page 12.
- Debt Proceeds – represents \$47,110,000 of 2009 lease revenue bonds issued to finance Honda improvements. This debt is secured by minimum annual guarantee in Honda lease agreement
- City – the City's Marina Enterprise Fund is paying for the marina dredging project and the City is loaning \$750,000 to the Port for Subaru improvements
- Port Cash – represents amounts funded by Port operating surplus
- Unfunded – represents project whose revenue source has not yet been identified

Following is a schedule showing the Port's grants as of March 31, 2011:

| <i>Granting Agency</i> | <i>Project</i> | <i>Award Amount</i> | <i>Life-to-Date Expenditures</i> |
|---------------------------------|-----------------------|----------------------------|---|
| Ass'n of Bay Area Governments | Bay Trail Project | \$ 289,000 | |
| U.S. Dept of Homeland Security | Video Surveillance | 2,311,138 | |
| Calif Emergency Mgmt Agency | Video Surveillance | 754,507 | |
| Calif Emergency Mgmt Agency | PPMT Lighting | 2,650,000 | |
| Calif State Coastal Conservancy | Bay Trail Project | 97,000 | |
| CalTrans | Bay Trail Project | 350,000 | |
| U.S. Dept of Homeland Security | Fiber Optic Network | 4,310,504 | |
| Calif Emergency Mgmt Agency | Security Center | <u>3,787,889</u> | <u>\$154,561</u> |
| | | <u>\$14,550,038</u> | <u>\$154,561</u> |

IV. FINDINGS AND RECOMMENDATIONS

1. ORGANIZATION STRUCTURE

The Port's strategic plan states that "The valuable real estate and coastal waters belonging to the community should be cared for in a manner that protects the interests of that community through, environmental stewardship, economic development and job creation." The Port's mission is "...to obtain the maximum financial benefit to the City."

Infrastructure investment needs will continue to be a major burden for the smaller ports, including the Port. When a port is governed by a city council, its infrastructure needs frequently are delayed as more pressing social issues are addressed. As a result, more ports are moving toward the privatization of managerial and financial responsibilities. Privatization allows some ports to stay competitive with the upgraded facilities needed to meet the needs of shipping lines.

In one privatization model, a port authority is established to own the land, berths and other infrastructure. The port authority would take direction from the City Council as it relates to broad public interests. Otherwise it would be autonomous, own its own assets, set its own budget, manage investments, establish staffing levels and pay, and have its own governing body. A private company or another port would be hired to manage the commercial side of the transactions. The port authority would spell out service quality, goals and social obligations that port management must meet. It would retain the right to set overall policies for the port but would forego making operating decisions. This, in effect, would give the professional port managers the same authority and responsibility as if they were functioning in the private sector.

There are other privatization models that would require the City to sell the Port's assets. Those models are not described here and are not being recommended.

Recommendation

The City should consider establishing an autonomous port authority to manage the port in a manner to make it more competitive with other ports. Alternatively, the City should consider the benefits of outsourcing operational management another port or to a professional port management firm.

2. PROPERTY MANAGEMENT

The Port has significant land and building assets that were acquired at various times over the past several decades. The City has not conducted appraisals of its land and buildings and therefore does not know their market value. In the last 15 years, Port management estimates that the City has invested over \$40 million in capital improvements for projects such as rail line extension, environmental cleanup and dock/pier improvement. The Port currently has capital projects underway totaling over \$28 million as described on page 11. There are numerous other capital projects that need to be undertaken for the Port to continue to draw tenants, including electrical system upgrade, timber wharf replacement, Riggers Loft building renovation, Point Potrero general warehouse renovation, terminal 2 berth upgrade, terminal 4 docks/piers replacement, and cafeteria building renovation.

Several large governments, including seaports, have started using public-private partnerships to finance their large capital projects. These partnerships are frequently structured so that the private partner pays a large upfront cash payment and agrees to make certain capital improvements. In return the private partner gets a long term lease at a reduced rental fee. The government retains ownership of the land and improvements and the end of the lease term.

The Port has no property manager. A property manager would focus on maximizing revenue for each parcel of land by understanding each parcel's highest and best use, understanding the needs of potential tenants and buyers, developing plans to make needed improvements and obtain related funding. These duties were partially handled by the former Port Administrator, a position vacant since October 2010.

Recommendations

The City should hire or engage a property manager to develop detailed plans to maximize return on investment to the City for each parcel by studying the competitive needs of its current and potential tenants; renew current leases having lower than market value rents as described in Finding 5; develop and prioritize a list of needed facilities improvements; secure financing to improve the facilities; and lead the global Environmental Impact Report the Port has initiated.

The Port's master list of needed capital projects should be formalized and prioritized. The criteria used to determine when a desired project is placed on the master list and the criteria used to prioritize those projects should be defined.

3. LOANS PAYABLE TO CITY

The Port and City entered into a promissory note dated May 2006 and amended May 2007 whereby the Port agreed to repay the City \$17,139,188 plus interest for "Port terminal leases and other Port projects financed by the General Fund." The only documentation that City and Port personnel could locate indicates that original loans were made between 1985 and 1995 in annual amounts ranging from approximately \$387,000 to \$2.0 million, and that the note amount is composed of \$8,872,397 of principal and \$8,075,597 of accrued interest. This documentation did not specify the purpose of the loans.

There are several problems with the calculations of interest on these loans:

- Prior to execution of the first promissory note in May 2006, there is no evidence of intent or agreement that the loans would carry interest nor what interest rate would be used
- The period for which interest was charged is not consistent. It appears interest was charged each year through June 30, 2004, not charged from then until June 30, 2009 and again charged starting July 1, 2009
- The interest rate used may not be consistent. The only calculations the City could provide of interest indicates that 5.5% was used for fiscal years 2002-03 and 2003-04. There is no documentation of how this 5.5% rate was determined.

- The promissory note indicates that the interest rate starting in fiscal year 2006-07 will be the three-year average of the State of California Local Agency Investment Fund’s rate, however the promissory note also refers to a rate of 4.000%.
- The balance on which interest is calculated is not clear. It is normal for interest to be determined based on the outstanding balance (principal and interest totaling \$17,139,188). Up to fiscal year 2003-04, interest was calculated based only on the outstanding principal balance (\$8,872,397).
- The interest accrued for fiscal year 2009-10 incorrectly excluded interest on the 1995 principal amount of \$334,647. Beginning with the promissory note in fiscal year 2006-07, interest is calculated on the entire outstanding balance.

There is inadequate documentation of the underlying services provided by the City that lead to the need for Port’s repayment to the City. As mentioned above, the only documentation provided by Port and City staff shows the year of each loan amount but no details of what the funds were advanced for. The first paragraph of the promissory note dated May 27, 2007 identifies the reason for the loan as follows: “Since on or about December 2004, the City of Richmond (City) has provided the following services to the Port of Richmond (Port): Port Terminal Leases and other Port projects financed by the General Fund.” However, the loans originated in the period 1985 through 1995. In addition, the description of the specific services provided by the City is not clear (i.e., it is not clear how “Port Terminal Leases” would lead to required repayments to the City).

The Port is not in compliance with and the repayment schedule included in the promissory note. The note calls for annual repayments to the City each fiscal year as follows:

| | |
|---------------------|-----------|
| Fiscal year 2006-07 | \$ 50,000 |
| Fiscal year 2007-08 | 50,000 |
| Fiscal year 2008-09 | 6,350,000 |
| Fiscal year 2009-10 | 2,000,000 |
| Fiscal year 2010-11 | 2,000,000 |
| Fiscal year 2011-12 | 2,000,000 |
| Fiscal year 2012-13 | 2,000,000 |
| Fiscal year 2013-14 | 2,000,000 |
| Fiscal year 2014-15 | 689,855 |

The two \$50,000 repayments were made as scheduled. However, no payments have been made since then.

State law requires a reasonable relationship between the payment of a fee and the purpose for which it is charged. Therefore it is important that the City have adequate documentation of all charges paid by the Port to the General Fund and be able to demonstrate the value provided to Port tenants.

Generally accepted accounting principles require that the Port have both the intent and ability to repay a liability for it to be appropriately reported in its financial statements. The Port’s intent to repay is documented in the promissory note. However, its ability to repay is in substantial doubt.

It has repaid only approximately \$285,000 in the last 25 years including none in the last four years. The Port's five-year financial forecast shows an aggregate operating deficit of over \$2 million during fiscal years 2011-12 through 2014-15.

Recommendations

The City should locate and document the specific services provided to the Port that led to the \$8,762,397 of loans. For any portion of the loans for which documentation is not available, the City and Port should remove the related loan amount from their accounting records. Note that removing the loan from the accounting records does not necessarily remove the legal liability to repay the loan should the Port later gain the ability to repay.

The City and Port should determine the Port's ability to repay the loans. If it is not clear that the Port has such ability within a reasonable time, the amount exceeding the Port's ability to repay should be removed from the accounting records.

The City should recalculate the amount of interest due on the outstanding balance since its inception based on a consistent and defensible methodology. The method described in the promissory note (three year rolling average of LAIF applied to the average outstanding balance each year) is an example of a reasonable method.

The City and Port should update the promissory note to better define the services for which the Port is repaying, update the repayment schedule and clarify how the interest rate is determined.

4. LAYBERTH VESSELS

The Port is missing out on significant revenue per year from layberth vessels. Layberth means temporary docking of vessels between assignments. In approximately December 2009, the Port stopped accepting layberth vessels. In order to accept layberth vessels, Federal law requires the Port to have a security officer and to have a security plan approved by the Coast Guard. The Port was previously allowed to accept layberth vessels using the security officer and security plan of a former tenant. Layberth revenue averaged approximately \$175,000 per year for fiscal years 2007-08 and 2008-09.

In Resolution 18-98, the City Council authorized the Port Director to enter into Temporary Berthing Assignment Agreements and provided the format of such agreement. However, the Port has not used this agreement nor any other written agreement for layberth vessels using Port facilities. The Port requires only a reservation request form to be completed; this form does not have any clauses to protect the Port against risks of damage to facilities or other losses.

Recommendations

The Port should appoint a security officer, develop and security plan, and submit it to the Coast Guard for review. If the workload of current Port managers is deemed more mission-critical, then a consultant should be hired to complete this task. As soon as the security plan is approved, the Port should advertise its reopening as a layberth location.

The Port should follow Resolution 18-98 by executing the Temporary Berthing Assignment Agreement for every vessel docking at the Port.

5. TENANT AGREEMENTS

The Port enters into lease agreements with each tenant. Of the Port's thirteen fiscal year 2009-10 tenants, there was no lease agreement in the Port's files for two tenants and for two others the lease agreements were not signed. The Port's leases were entered into at various dates since 1998. Six of the thirteen leases do not have a provision for rent increases. If these six agreements had automatic rent increases of 3% per year, the Port would have earned approximately \$20,000 more during fiscal year 2009-10.

Of the Port's thirteen fiscal year 2009-10 tenants, four lease agreements are with the Surplus Property Authority of the City of Richmond (the "Authority"). Per discussions with management of the Port, Finance, City Attorney and City Clerk departments, none knew of the origin nor purpose of the Authority. The City's annual financial report states that the Authority was "formed to become the owner of certain property declared surplus by the U.S. Government" and that "the Authority is inactive".

The Port's lease agreements with Auto Warehousing Company (AWC) and Honda of California are large (several million dollars of Port revenue each year) and complex (minimum annual guarantee, volume rebate, significant capital improvements, different requirements during the construction period). Much of the information needed to determine the correct billing to tenants is received from the tenants. The only verification of such tenant-provided information is comparison of quantities to Port records. An example of a complex issue needing interpretation is that AWC sent its calculation of the minimum annual guarantee deficiency that used the tariff rate per vehicle of \$23.10 instead of the wharfage rate per the Honda agreement of \$25.50.

Recommendations

The Port should obtain signed copies of each active tenant agreement. It should negotiate lease amendments to include an escalation clause as each agreement expires. In the future, all lease agreements should include a provision for automatic rent increases.

The City should verify the status and purpose of the Surplus Property Authority. If it is determined to be beneficial to maintain, the City's annual report disclosure about the Authority should be updated. If it is not deemed beneficial to maintain, it should be dissolved.

Port operating personnel should study the Auto Warehousing and Honda leases to assure thorough understanding of their complexities and gain both City management and City attorney interpretations as necessary. Information received from the tenants that affect the Port's revenue should be closely scrutinized with knowledge of the agreements, historical trends and tenant operations.

6. FINANCIAL REPORTING

The Port's primary financial reports (budget, monthly financial statements, annual financial statements and five-year projection) are inconsistent in format. For example, the CAFR and the five-year projection use different expense categories:

- CAFR - salaries & wages, general & administration, maintenance, depreciation, and other.
- Budget, five-year projection, monthly financial statements - professional & administration, other operating, equipment & contract services, utilities, insurance, cost pool, capital outlay and debt service.

Another example is that the bases of accounting used for each of these reports differs: the annual financial statements use the full accrual basis, the budget and monthly financial statements use the cash basis, and the five-year projection uses a working capital basis.

There were several errors noted in the Port's primary financial reports, including:

- In the annual financial statements (CAFR):
 - Revenue from layberth vessels was incorrectly reported as "marina berth rentals" in fiscal years 2006-07 and 2007-08.
 - Lease revenue from Auto Warehousing Company was reported as "lease income" while all other lease revenue was reported as "service charges".
 - Port staff was unable to fully reconcile fiscal year 2009-10 revenue per the CAFR to the general ledger and the revenue report.
- In the five-year projection:
 - The Port's repayment to the City of \$750,000 for an advance to fund Subaru improvements scheduled for fiscal years 2011-12 through 2015-16 were inadvertently added rather than deducted from operating surplus/deficit.
 - Rental income for fiscal year 2010-11 of \$6,504,113 was input in error and should have been \$7,054,113.
 - Although the projection purportedly uses the working capital basis, unused debt proceeds was not included. This leads to the need to add an arbitrary revenue line item in the five-year projection for the estimated amount of debt proceeds to be used to finance capital projects. The Port called this amount (\$8,066,540 for fiscal year 2010-11) "operating transfers in" even though it is not a transfer.
 - A negative amount of \$1 million is shown for the terminal 2 wharf improvements capital project in fiscal year 2010-11.
 - The five-year projection repeated the expected amount of grant revenue and related capital outlay expenditures in multiple years. Specifically, the grant revenues discussed on page 12 and related capital expenditures were shown in their entirety in fiscal year 2010-11; the amounts not used during that year were then carried forward and shown again in the five-year projection in fiscal year 2011-12. This resulted in an overstatement in total revenues and expenditures during the forecast period of over \$8 million.

- In the budget and monthly financial statements:
 - Although the budget purportedly uses the cash basis, unused debt proceeds were not included. This leads to the need to add arbitrary revenue line items in the five-year projection for the amount of debt proceeds to be used to finance capital projects. The Port called these amounts “bond proceeds” and “capitalized interest” (\$30,636,961 and \$1,449,700, respectively, for fiscal year 2009-10).

Because of the inconsistent formats and errors, the Port’s primary financial reports are hard to interpret, internally inconsistent, difficult to answer questions about, difficult to reconcile to each other and therefore of limited reliability to Port and City management.

Recommendations

The City should determine the most appropriate format, level of detail and basis of accounting to depict Port operations. This format should be used for every Port financial report or presentation. If the City determines that the Port’s budget must be prepared on a basis of accounting other than full accrual, then the budget format should depart as little as possible from the format determined for the Port reports. The five-year projection should be prepared on the full accrual basis, consistent with enterprise fund and business organizations.

The number of errors and inconsistencies in the financial reports indicates an inadequate level of review. Each report should be reviewed in detail by both Port management and City Finance prior to finalization and distribution.

7. SECURITY DEPOSITS

The Port collects security deposits from some of its tenants and returns it or applies it to the final rent payment when a tenant leaves. The amount of the deposit is typically equal to one month’s rent. The Port has no standard procedure for determining whether a security deposit will be required. Seven of the Port’s thirteen leases require security deposits. Of the six tenants required to have a security deposit, the Port holds such deposits only for two of them. The Port also holds a security deposit of \$3,000 for a former tenant who left the Port in 2009.

Recommendation

The Port should develop written procedures for security deposits, including the following:

- Circumstances a deposit is required, and how the amount is determined
- Include requirement for a security deposit in the standard lease agreement
- Maintain a separate listing of security deposits
- Account for security deposits in the general ledger
- Conduct annual reconciliation of security deposits to the general ledger
- Circumstances and method used to refund deposits
- Amount of time Port will wait before writing off unrefunded deposit

The Port should immediately collect security deposits from the four tenants having such requirement in their lease agreement who have not yet paid.

8. CERTIFICATES OF INSURANCE

All the Port's lease agreements call for the tenants to maintain adequate insurance. Of the Port's fifteen fiscal year 2009-10 tenants, the Port did not have certificates of insurance or other evidence of insurance for all required coverages for nine tenants. In addition, one certificate of insurance on file had expired and one certificate evidenced a lower amount of coverage than required by the lease agreement.

Recommendation

The Port should obtain certificates of insurance from each tenant demonstrating the appropriate coverages, limits and effective dates. They should develop and implement procedures to assure that certificates of insurance are obtained when new tenants move in and each year thereafter upon expiration of each policy.

9. GOALS AND OPERATING STATISTICS

The Port develops objectives, strategic goals, supporting actions and success indicators as part of the budget process each year. For the fiscal year 2011-12 budget, the Port identified five key objectives, two strategic goals, twelve supporting actions and 24 success indicators. Success indicators are linked to supporting actions which are, in turn, linked to goals. However, the goals are not clearly linked to the key objectives.

The two strategic goals (maximize revenue and improve facilities) and key objectives have been the same every year for each of the last three years. Having the same goals each year is indicative that goals are not specific enough.

Most of the success indicators gathered and reported are not useful for management decision making nor accountability, or they are not clear. The cost to gather the information therefore outweighs their benefit. Examples of ineffective success indicators are:

- # of annual customer satisfaction survey completed (1)
- # of Port industry conferences and meetings attended (4)
- Generate and review monthly P & L with Port management (12)
- % of state/fed security agency oversight compliance (100%)

Examples of effective success indicators used by the Port include revenue generated per acre and total cost per acre.

Recommendation

The Port should clearly link its strategic goals to its key objectives each year. The goals should be very specific and measurable enough to know when they have been accomplished. The Port should also revise its success indicators to assure that they are meaningful, cost-beneficial to gather, and accurate. It is better to have a small number of meaningful success indicators than a large number that are not important or hard to interpret.

10. FINANCIAL PROCEDURES

The Port has no documented financial procedures except those adopted at the City level. Some of the Port's financial operations are unique and are therefore not adequately covered by City policies and procedures. The Government Finance Officers Association recommends in its

Recommended Practices that every government document its accounting procedures “...as an essential component of a comprehensive framework of internal controls.” Documentation of comprehensive accounting procedures will allow:

- Management to understand and evaluate whether procedures provide adequate internal controls and mitigation of risks
- Employees to review and revise procedures as circumstances, laws, technology and accounting standards change
- Internal and external auditors to assess the adequacy of the Port’s internal controls
- New employees to be trained to provide consistent service and quality upon staff turnover

The Port has been awarded eight grants totaling \$14,550,038 for capital improvements as discussed on page 12. Although the Port had a significant grant in fiscal year 2007-08, it has no written or otherwise well-established procedures for accounting for grant expenditures, preparation and review of reimbursement requests and compliance with grant requirements.

Recommendation

The Port should identify and document its significant financial procedures, except for any existing City procedures that are considered adequate to address the Port’s activities. Procedures should include those tasks required to be performed by Port employees for all of the main types of business transactions, including:

- Cash receipts (invoicing, writing receipts, billing and collection)
- Purchasing (use of purchase orders, petty cash, purchasing cards, contracting, receiving)
- Payroll (distribution of costs, travel and expense reimbursements)
- Capital assets (acquisition of land and equipment, periodic physical inventories, capitalization thresholds, depreciation calculations)
- Reporting (internal monthly reports, periodic reports to the Council, annual audit)
- Budget (annual budgeting, budget vs. actual comparisons, cash flow projections, long-range planning)
- Grants (cost accumulation, reimbursement requests, compliance monitoring)
- Internal controls (segregation of duties, responsibilities for establishing and monitoring controls)

11. OPERATING PROCEDURES

The Port has not documented its standard operating procedures. Written procedures will:

- Ensure that everyone doing the work understands the task, including current and future employees
- Ensure consistency with other City departments doing similar tasks
- Improve efficiency by assuring each task is thoroughly understood and reviewed by management, eliminating time spent “reinventing the wheel” each time a task is done, and reducing the need for re-work
- Improve quality by reducing inconsistencies in the work product

A Port tenant went bankrupt in November 2008, owing the Port 37 months of rent. \$134,800 was approved for write off at the June 2011 City Council meeting, more than four years after the tenant moved out. The City did not file a claim with the bankruptcy court and therefore did not collect any amount through bankruptcy proceedings. The Port has no formal procedures for checking credit of tenants before they move in. The City did not comply with Administrative policy AP251 "Write Off of Delinquent Accounts" which states:

"Each quarter the Finance Department, the appropriate operating department director and the City Attorney shall review delinquent accounts receivable as shown on the Accounts Receivable Aging Report form (Exhibit 503-6) to assess their collectivity."

Recommendation

The Port should identify its major operating procedures. These procedures may include property mgmt, disaster planning, communication with tenants, communication with vessels, tenant move-in and move-out, tenant background checks, security, budgeting and related monitoring, capital project planning and funding. For each major operating procedure, the Port should document the related tasks. This documentation is best done by employees during their normal performance of each task and then reviewed by Port management.

12. MARINA DREDGING PROJECT

The City has asked the Port to manage the Marina dredging project. The Port is budgeting this project in fiscal year 2011-12. It is anticipated that the Richmond Marina enterprise fund will transfer \$2.1 million to the Port to cover the cost of dredging. However, no mechanism for reimbursement of the Port for the cost of management and staff time has been established. The City charges the Port \$942,802 per year for its share of City indirect costs so it is consistent with City practice to reimburse the Port for its costs of managing this non-Port project.

Recommendation

The City should estimate the cost of Port management and staff time on the Marina dredging project. This amount should be included in the budget for reimbursement to the Port.