Port of Seattle

Internal Audit Report

Portside Cafe
Management Services Agreement

Audit Period

January 1, 2008 through December 31, 2009

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Internal Auditor's Report

We have completed an audit of Portside Café. The Port of Seattle owns the cafeteria, but the operation is outsourced to Consolidated Food Management, Inc. (CFM) under a management services agreement. CFM is a regional food management company and oversees day-to-day operations of the facility. The Port Pier 69 Facility Management Department administers the management services agreement.

We conducted the audit using due professional care. The audit was planned and performed to obtain reasonable assurance of compliance with agreed-upon terms and conditions of the management services agreement. We also evaluated the efficiency and effectiveness of Port management's monitoring of the agreement.

Port management has the primary responsibility to establish and implement efficient and effective monitoring. Our role was to assess and evaluate the monitoring in order to determine whether the monitoring was adequate and operating as intended.

Port management's monitoring system was not effective. The audit disclosed significant exceptions related to payroll outlays, unauthorized expenses, and noncompliance with management agreement. Collectively, the auditor suggests recovery of more than $70,000. Moreover, the management agreement itself (as written) does not comply with certain applicable state rules and regulations.

We extend our appreciation to Pier 69 Facility Management, Consolidated Food Management, Inc., and Accounting & Financial Reporting staff for their assistance and cooperation during the audit.

Kirangi

Joyce Kirangi, CPA
Internal Audit Director

Executive Summary

Audit Scope and Objective The purpose of the audit was to determine whether

1. Port management has established a system of adequate monitoring to reasonably ensure compliance with the agreement.
2. Financial transactions were Portside Café related and completely recorded with proper supporting documentation.
3. The management agreement, as amended, complies with applicable state and Port rules and regulations.

Agreement Terms CFM is a regional, on-site food management company headquartered in Mercer Island, WA. The company provides food services to more than 20 industry and institutional facilities including the Port.

Per the agreement, CFM is responsible for overall management of the cafeteria, including catering services. The Port is financially responsible for all Café expenses: cost of food, beverage, labor (i.e. costs related to compensation for CFM employees working at the cafeteria), supplies, and CFM management fees.

Portside Café generates revenue from two different sources. Most of the revenue (>80%) comes from providing a full range of food and beverage at the cafeteria, and the rest of the revenue comes from catering for Port and private social events. The cafeteria has been generating annual revenues of approximately $280,000 while incurring average expenses of more than $430,000 per year. The cafeteria for the past several years has been operating at an average net loss of $150,000.

Port management requested an audit of the Café operation prior to issuing a Request for Proposal (RFP) in June of 2010.

Audit Result Summary Port Management was not effective in monitoring the agreement. The audit disclosed exceptions related to payroll outlays, unauthorized expenses, and noncompliance with the management agreement. Collectively, the auditor suggests recovery of more than $70,000. In addition, the agreement itself (as written) does not comply with certain state statutory requirements.

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Background

The Port of Seattle (POS) owns a cafeteria, Portside Café, located at 2711 Alaskan Way. The day-to-day operation of the cafeteria is outsourced to Consolidated Food Management, Inc. (CFM) through a third-party management services agreement. The original agreement was solicited and awarded to Delicor Dinning Services, Inc (Delicor) in 1992. In 1998, CFM acquired the agreement through assignment and Port management consented to the assignment.

CFM is a regional, on-site food management company headquartered in Mercer Island, WA. The company provides food services to more than 20+ industry and institutional facilities including the Port of Seattle. CFM runs the Portside Café on behalf of the Port for a fixed monthly fee.

Revenue from Portside Café is generated from two different sources. Most of the revenue (>80%) comes from providing a full range of food and beverage at the cafeteria and the rest of the revenue comes from catering services for the Port or private social events.

The cafeteria generates annual revenue of approximately $280,000, and its expenses are slightly over $430,000. Per the agreement, any loss where the cost of operation exceeds revenue is borne by the Port. For the past several years, the Café has operated at an average annual net loss of $150,000.

Financial Highlights

Description	2006	2007	2008	2009
Revenue				
Catering	$118,362	$91,542	$75,676	$56,443
Food & Beverage	219,463	195,325	225,438	227,118
Less WSST	(28,745)	(24,561)	(26,077)	(25,513)
Coffee Club	7,887	7,132	7,528	5,625
Total Revenue	$316,967	$269,438	$282.565	$263,673
Expense				
Food Cost	150,357	141,050	155,177	145,606
Labor Cost	202,081	189,509	210,911	208,598
Operating Cost	50,040	50,488	55,835	56,151
Management Fee	15,000	15,000	15,000	15,000
Coffee Club	4,220	14,815	16,650	13,754
Total Expenses	421,698	409,614	453,573	439,109
Net Loss	**($104,731)**	**($140,176)**	**($171,008)**	**($175,436)**

Source: Portside Café P&L (Profit and Loss) and PeopleSoft

Port management requested an audit of the Café operation prior to issuing a Request For Proposal (RFP) in June of 2010.

Audit Objectives

The purpose of the audit was to determine whether:

1. Port management has established a system of adequate monitoring to reasonably ensure compliance with the agreement.
2. Portside Café expenses were proper, valid, and properly supported.
3. The management agreement, as amended, complies with applicable state and Port rules and regulations.

Audit Scope

The scope of the audit covered the period 2008 through 2009.

Audit Approach

To accomplish our objective, we performed the following audit procedures:

- Read and analyzed the management agreement, as amended.
- Reviewed applicable state and local laws, rules and regulations, and Port policy and procedure.
- Interviewed department and the management company staff.
- Obtained a complete understanding of activities of the cafeteria, applicable systems, processes and controls, and transactions.
- Analyzed applicable internal and external data.
- Assessed relevant risks associated with the agreement.
- Designed and executed our audit procedures based on risks.

Conclusion

Port Management was not effective in monitoring this services agreement. The audit disclosed exceptions related to payroll outlays, unauthorized expenses, and noncompliance with the management agreement. Collectively, the auditor suggests recovery of more than $70,000. In addition, the agreement itself (as written) does not comply with certain state statutory requirements.

Summary of Findings and Recommendations

I. Ineffective Monitoring of the Portside Café Management Agreement

A system of monitoring is necessary to provide Port management with reasonable assurance of compliance with agree-upon terms and conditions. Such a system should be based on an analysis of risks related to the agreement and implementation of key controls to mitigate identified risks. Port management then determines how the controls will be monitored to ensure continuous compliance.

Port management's monitoring of the agreement was not effective. The monitoring was cursory and based on an honor system. Our audit disclosed a number of discrepancies including disallowed expenses. An effective on-going monitoring system would have identified and remedied these discrepancies.

1. Lack of Adherence to the Agreement Terms

   a. The original agreement was awarded in 1992 for a term of one year with an option to extend the agreement up to two (2) times for an additional one (1) year term. Port management has consented to a number of assignments of this agreement to separate food services providers including Consolidated Food Management. The original 1-year agreement has remained in place for 18 years.

   b. Under Article VII.3 of the agreement, the goal of the Portside Café was to break-even. However, the Café has been operating at a loss for the past several years. To the extent of the loss incurred, the Port has subsidized Portside Café patrons who are mostly Port employees.

   (in thousands)

Description	2003	2004	2005	2006	2007	2008	2009
Total Revenue	368	323	323	317	269	283	264
Total Expense	419	424	398	422	410	454	439
Net Loss	($51)	($101)	($75)	($105)	($141)	($171)	($175)

   Source: Portside Café monthly Profit and Loss (P&L) statements

   It's not clear whether the above increase in loss subsidies fall within the original scope of the Port Commission intent to operate Portside Café at a break-even. It's also unclear whether Port Commission is aware of the heavy subsidies the Port pays to keep the Café in operation. Further, we could not find any statutory authority that allows a Port district to subsidize its employee meals or food. The consumption of food or nourishment is considered private and personal, and subsidy of employee meals could be deemed a gift of public funds which is prohibited by Washington State Constitution.

   c. Article VII.6 of the agreement specifically disallows certain items from reimbursable expense. Based on our audit, we noted the Port paid for disallowed expenses as follows:

i. $4,200 ($2,100/year) for accounting expenses.
ii. $181 (10.50 hours**)** for unauthorized overtime.
iii. $313 for an unauthorized Point of Sales (POS) maintenance contract.

d. Article III.15 requires purchase and usage records of food and beverages to be inventoried and submitted to the Port of Seattle on a monthly basis. We observed there was no inventory taken during the audit period. Consequently, we could not ascertain the true Cost of Goods Sold (COGS), spoilage, or loss.

e. The Portside Café offers a 15% sales discounts to patrons including Port employee. Although Port management may have verbally authorized the discount, the agreement was not formally amended to reflect the approval.

f. CFM did not submit for the audit period a written budget with estimated sales, food costs, revenues, and expenses, as required under Article III.13. Further, despite continuous operating loss from Portside Café operation, we found no evidence of management analysis of the cause and or alternatives that would make the Café operates more efficiently. The required budget would have been used by Port management to assess Portside Café operation and efficiency.

2. The Port agreed to pay for all direct costs related to the Portside Cafe, including compensation, benefits, and payroll taxes for CFM employees working at the facility. The audit discovered that the Port reimbursed CFM for payroll taxes and benefits base on a fixed percentage/amount, as opposed to the *actual cost* incurred.

a. The Port paid flat 25% for payroll taxes and benefits during the audit period. When compared to actual expenses per the audit, the percentage payment represented an overpayment of approx. $1,879/month. If we extrapolate this figure for the 2-year audit period, the total estimated overpayment on payroll taxes and benefits would be approximately $45,096 ($1,879 x 24).

The reimbursement of payroll taxes based on the fixed percentage amount appears to extend well beyond the audit period as summarized below.

(In thousands)

Description	2003	2004	2005	2006	2007	2008	2009
Wages & Salaries	$145	$152	$146	$146	$139	$151	$150
Vacation Accrual	1	11	5	4	4	6	6
Total Gross Payroll	146	163	151	150	143	157	156
Payroll Tax/Ben Payment	34	38	35	36	34	39	39
% of Gross	23%	23%	23%	24%	24%	25%	25%

Source: Portside Café monthly Profit and Loss (P&L) statements

b. The Port paid fixed $750/month for medical insurance. A review of the insurance payments for six months indicated an overpayment of approximately $386.47. When we extrapolate this figure for the 2-year audit period, the total estimated overpayment would be $1,546 ($386.47 x 4).

3. CFM charges its catering customers, including the Port, an 18% Setup & Delivery Fee for necessary time and effort to “set up” venues and “deliver” food. The company does not utilize a contract to engage catering events. Rather, a simple invoice is used to bill itemized services. Nowhere in the invoice is the fee specified as gratuity; nevertheless, the company has considered the fee as gratuity and paid out as bonuses/gratuities to its employees. For the audit period, there was approximately $18,000 of such fees.

4. CFM has 7 paid holidays and the Port has 10 holidays. CFM employee, per the company policy, may choose to take paid-time-off for Port holidays that do not coincide with CFM paid holidays. We noted that CFM employees were compensated as hours worked for non-CFM Port holidays. We observed approximately $2,242 of such payments.

   CFM employee benefits include unused vacation payout at separation and annual cash-out of unused vacation at year end. Both types of vacation payments have been fully included in reimbursable expenses by the Port. Thus, incorrectly paid holidays represent an overpayment.

5. The following are miscellaneous exceptions noted.
   a. The company paid for a non-Portside related expense of $514.
   b. An employee was compensated for 25 hours ($276) related to post-termination dates.
   c. A payroll error ($1,186) was not credited back to the Port.

Recommendation

We recommend Port management:

a. Implement controls to ensure that Portside Café expense are proper, reasonable, and legitimate.
b. Recover $4,695 related to unauthorized expense items.
c. Recover $46,642 related to overpayments in payroll taxes and benefits.
d. Recover $18,000 related to catering Setup & Delivery Fee.
e. Recover $2,242 related to unauthorized expense for holiday pay,
f. Recover $1,977 in miscellaneous overpayments.
g. Conduct a complete review of accounting records for improper payments during the audit period. The suggested recovery is only based on audit procedures performed and does not represent the full extent of potential overpayments.
h. Consider reviewing calendar years prior to the audit period for potential overpayments.

Management Response

a. Real Estate Division management appreciates the thorough analysis performed by the Internal Audit group; division management requested this audit in anticipation of issuing an RFP in Q2 of 2010. Our objective was to use the results of the audit to inform the RFP strategy and effectively deal with known problems and areas of concern with the existing third party management agreement.

Due to audit findings which indicated that the management agreement with CFM is not in compliance with state rules and regulations, the food service operation was closed on Friday, April 30, 2010.

Port staff will begin work immediately to determine the best way to replace the operation, and will structure any related agreements in a manner that will facilitate efficient and effective monitoring.

b. *Staff will attempt to recover the unauthorized $4,200 in accounting expenses and the $181 in overtime pay. The $313 for the maintenance contract on the Port owned point-of-sales system was verbally authorized, so we will not seek to recover that expense. Staff will ensure that any new food service third party management agreements require more detailed documentation to facilitate monitoring of expense items. Staff will discontinue the use of verbal authorizations.*

c. *Staff will attempt to recover the noted overpayments in payroll taxes and benefits, and will ensure that any new food service third party management agreements require more detailed documentation to facilitate monitoring of payroll taxes and benefits.*

d. *Staff will attempt to recover the noted "setup & delivery fees," and will ensure that any new food service third party management agreements require that gratuities are clearly identified in any catering proposals, and will require more detailed documentation to facilitate monitoring.*

e. *Staff will attempt to recover the noted overpayments for holiday pay, and will ensure any new food service third party management agreements require more detailed documentation to facilitate monitoring of this item.*

f. *Staff will attempt to recover the noted miscellaneous overpayments, and will ensure that any new food service third party management agreements require more detailed documentation to facilitate monitoring of miscellaneous expenses.*

g. *A complete review of accounting records for improper payments during the audit period due will not be conducted due to limited staffing resources.*

h. *A review of calendar years prior to the audit period for potential overpayments will not be conducted due to limited staffing resources.*

II. Noncompliance with State Laws and Regulations

A Port in Washington State is a special purpose district and is subject to numerous state requirements under RCW. Port management should have controls in place to ensure that agreement language reflects and complies with applicable state laws and regulations.

The Portside Café agreement (as currently written) does not comply with the following state laws and regulations.

1. RCW 43.09.240 and the State Constitution require public receipts be deposited with the public entity treasurer within twenty-four hours.

   a. The Port has not established an account for use in connection with receipts and payments associated with the operation of the Portside Café. CFM has been depositing Portside Café daily receipts into its own account and drawing funds from the account to cover operating expenses.

2. RCW 42.24 requires 1) claims (i.e., expenses) be subject to auditing and be certified by an auditing officer before payment and 2) the Commission approve all claims against the Port.

   a. Port management acknowledges Portside operating expenses and approves monthly net income or loss based on the Profit and Loss statement and other summary documents submitted by CFM. Individual source documents (i.e. vendor invoices or employee timesheets) are neither reviewed by management nor certified by the Port auditing officer. The Portside Café expenses also do not go through the Port Commission for approval as required by state law.

3. WAC 458-20-254 and RCW 82.32.070 require sale receipts be retained for a period of five years, and RCW 40.14 – public record retention schedules specify that public records be maintained on an average of six years.

   a. The agreement is not compliant with the state requirements. Under Article III.14, the agreement requires record maintenance for the current fiscal year and for a minimum of one previous year, which is considerably less than the state records retention requirements. For example, prior to 2009, CFM did not retain Z-tape detailed sales register reports. As a result, we could not verify completeness of the 2008 revenue.

4. Per RCW 74.18.200, the state Department of Services for the Blind has the primary right to operate food services/cafeterias in any public building dedicated to the administrative functions of the state or any political subdivision, unless the Department waives its right.

   a. The Port did not consult with the Department of Services for the Blind to provide it with the primary right to run the Portside Café or to obtain an exemption.

      The operation of the Portside Café is further complicated by the fact that the Port has been using public funds to subsidize Portside Café operation. This subsidy for food consumption has gone on for many years, and it averages to approximately $150,000 per year. The consumption of nourishment is private, personal, and not an activity that is undertaken for a public purpose. The subsidies seem to violate Washington State Constitution that prohibits gifting of public funds.

Recommendation

We recommend Port management:

a. Implement controls to ensure

    a. All public funds (receipts) are deposited into Port's bank account within twenty-four hours as required by state laws.
    b. All individual claims and expenses against Portside Café are properly reviewed, certified, and subject to the Commission approval.
    c. Consider establishing a revolving bank account for payment of Portside Café expenses – this would cure most of the state non-compliance issues that currently exist with this agreement.

b. Amend the record retention requirement in the agreement to make it consistent with applicable state requirements.

c. Work with the Legal Department to re-evaluate the current Portside Café operating structure, including the subsidy legal issue. If the subsidies are deemed to be an improper gift of public funds, these subsidies should cease immediately. To avoid legal complications and excessive time & effort to monitor this agreement, we would recommend simply leasing the Café space including its equipment to an outside vendor.

Management Response

a. *(a)The need to deposit daily cafeteria receipts into the Port's bank account was brought to Port management attention by Internal Audit shortly before this audit was conducted. Staff will implement this control for any new food service third party management agreements.*

(b) Regarding the reference to RCW 42.24, the following clarification is offered to better describe the protocols followed in regards to the Portside Café expenses and revenues.

Monthly, CFM provides a "Vendor Detail Supporting Schedule" that lists by Expense Category (meat, beverage, produce, dairy, paper, transportation, etc.) and then by each Individual Invoice (by date, vendor, invoice #, amount). This detail is reviewed by Port management as to the expenses incurred. This is then reconciled to the Profit/Loss statement also provided by CFM. A monthly payment is then made to pay CFM for the detailed expenses, netted against revenues for the month, through the Port's standard payments process and included in the monthly Port Commission payments approval process. Although the detailed invoices/vendor payments made by CFM to operate the cafeteria are not processed in detail, as noted in the finding, Port management review is afforded those detailed payments monthly and the payments made by the Port to CFM do follow the Port auditing officer and Commission payments approval process.

Additionally, from the monthly Profit/Loss statements received from CFM, the Port records in its financial system both monthly revenues and operating expenses on a gross basis, to completely and accurately reflect all revenues generated and expenses incurred.

(c) Division management will consult with the Port Treasurer and request the establishment of a revolving bank account for payment of Portside Café expenses for any new food service third party management agreements.

b. Any new food service third party management agreements will state that customer receipts must be retained for a period of five years.

c. Interpretation from the Legal Department will provide division management with needed direction to help determine future use of the space.