

ITEM NO. 7a Attach 1

DATE OF
MEETING 5/24/2011

Annual Action Status Report
July 1, 2011
SAO 2010 Performance Audit
Port of Seattle
SAO Audit Report No. 1004635

This action status report addresses 10 recommendations submitted to the Port of Seattle following the Washington State Auditor's Office performance audit report that focused on the Port of Seattle's Real Estate management and selected programs.



SAO AUDIT RECOMMENDATION 1: We recommend the Port complete its Century Agenda as soon as possible and include the following elements:

- Specific goals and objectives to use real estate holdings to achieve financial security and promote economic development and community stewardship. The Port needs to set priorities and clarify the sometimes conflicting direction of Strategy 21's guiding principles. For example, the importance of generating revenue may conflict with the need to provide financial incentives to attract job-creating industries. The absence of priorities can create inconsistent and unclear decisions that do not align with long-term goals. These conditions may have contributed to the unexplained inconsistencies in lease rates and rate hikes discussed in Section 3.
- Identification of the specific types of businesses and industries –outside of traditional air-and sea-related companies–that the Port wants to secure and maintain as short-and long-term tenants.
- Goals and objectives that describe how the Port can best use its real estate to compete with other West Coast ports for tenants, industries and importers/exporters.

Port of Seattle Action Status to Recommendation 1:

The Port Commission is making excellent progress on the Century Agenda effort. The Commission has reviewed the SAO recommendations and, where possible, incorporated them into the ongoing Century Agenda process.

The port began the Century Agenda strategic planning process in 2008, with the goal of crafting a comprehensive vision and strategic plan for the port's next quarter-century. The strategic planning process reflects upon the accomplishments of the organization's first 100 years and will develop a new set of goals and objectives that reflect the challenges and opportunities of the 21st century.

On August 4, 2009, the commission adopted the "*Century Agenda: Expert Panels' Recommended Guiding Principles.*" Since that time, both the commissioners and port staff have engaged in iterative discussions to transform the principles into measurable goals and objectives. On January 4, 2011, the Century Agenda Committee, chaired by Commissioner Albro, and joined by Commissioner Creighton, was approved by the commission and tasked with completing the strategic plan.

The Century Agenda Committee has held numerous meetings thus far in 2011. The committee will host at least one public panel discussion each month from March until October. Panels will be composed of members of the public who have particular expertise in areas such as strategic planning, economic development, movement of cargo and people, and environmental and financial policies.

At the time this report is published, four panels will have occurred: a media roundtable, which included area journalists who reflected on the challenges they see facing the region in the coming 25 years; an economic development panel, which focused on emerging opportunities; efficient movement of cargo by sea, rail, and air; and efficient movement of people through airport and cruise facilities. Future panel topics include: the port's real estate portfolio; , community environmental values; and funding the port's operations.

Commissioners will develop a preliminary strategic goal after each roundtable, and that goal will be presented to the Commission for approval. By late September, a short list of strategic goals should be reviewed and approved by the commission. Port staff will then determine the five-year

objectives necessary to achieve those goals. Final approval of both the strategic goals and their objectives will be completed by December 2011.

SAO AUDIT RECOMMENDATION 2: To ensure clear and consistent real estate management, we recommend the Port clarify the responsibilities of the Real Estate and Seaport divisions and improve the enforcement of its policies and procedures.

It is equally critical for senior managers to improve oversight of Port property transactions and to monitor employees' compliance with new policies and procedures.

Port of Seattle Action Status to Recommendation 2:

CEO Tay Yoshitani established the Real Estate division in 2008 to bring more focus to managing the port's real estate portfolio, and responsibilities within the relatively new division continue to evolve. The Managing Directors of the Seaport and Real Estate Divisions have reviewed their respective real estate portfolios in order to determine if any of the properties should be managed by the other division. The criteria used were the following:

1. Is the facility a marine cargo or passenger facility?;
2. Does the facility or property provide necessary support for businesses in category one?;
3. Is the property strategically important for future growth of seaport terminals?;
4. Is the leased property located in the middle of a seaport terminal where having two divisions involved would be cumbersome and inefficient?

Based on the above criteria, all leases were reviewed, and leases at Terminal 91 uplands, Pier 69 and Terminal 115 were considered for transferring between divisions. While a number of leases at these facilities could be shifted to the other division based on the first two criteria above, criteria four was the deciding factor in keeping the lease assignments as is. One lease at Terminal 107 was moved to the Real Estate Division.

Oversight over compliance with policies and procedures is critical and the procedures developed in response to Recommendation 6 address this issue.

SAO AUDIT RECOMMENDATION 3: We recommend the Commission assert the same level of authority over real estate transactions that it established in Resolution 3605 for construction management. In this audit, we identify conditions in which Port managers do not always provide complete and accurate information that the Commission needs to make sound real estate decisions. The Commission needs to ensure staff collect, track and convey key information related to the cost and benefits of the leases to the Commission.

In the long-term, an updated strategic management plan approach may call for further reorganization of these divisions to ensure that policies, procedures and daily operations contribute to achieving the Port's vision and goals. As the Port updates its strategic plan, it may want to reassess its division of responsibilities over real estate property management.

Port of Seattle Action Status to Recommendation 3:

In adopting Resolutions 3605 and 3628, the Port Commission considered its role and oversight in both the Port's construction management and real estate property management practices. These are two very distinct functions. As such, these resolutions apply two different, yet appropriate, approaches to commission versus staff authority for these activities. The Commission is currently reviewing Resolution 3628 and will consider advisable changes as part of this process, including any revisions to sections two and three related to real estate agreements. The Commission expects to act on the proposed changes to Resolution 3628 this fall. Port staff members will communicate those changes to the SAO when they have been implemented.

As addressed in the response to Recommendation 2, the Seaport and Real Estate Divisions have reviewed property assignments to ensure the properties that support each divisions strategic goals is assigned to that division. Both Divisions also will use consistent procedures when managing real estate assets.

SAO AUDIT RECOMMENDATION 4: To strengthen its oversight of property sales and purchases, we recommend the Port Commission adopt and enforce policies that require staff to perform and document the following efforts:

- Regularly and thoroughly analyze the Port's current and future property needs in the context of the goals and objectives of a long-term strategic plan. These ongoing analyses should clearly describe the justification for all purchases and sales. Properties with no current or future need should be declared surplus and made available for sale. The Port should not declare property surplus simply to expedite a sale.
- Review in detail all property value appraisals and determinations by Port staff involved in the property sale or purchase. This should also include a concurrent review by the Port's chief financial officer to ensure the appraisal is fully understood. When it buys and sells property, the Port should use current appraisals to establish and negotiate a good fair market price.
- Perform complete financial and risk analyses of the purchase that include remediation costs, potential ownership costs and environmental conditions.
- Scrutinize information from staff to ensure it is adequate and complete and decide on purchases and sales in an open public meeting.
- Effectively market and advertise the availability of Port property to allow multiple purchasers an equal opportunity to buy it in order to achieve the best purchase price.

Port of Seattle Action Status to Recommendation 4:

The port's current policies RE-1 through RE-6 address various aspects of real estate acquisitions and sales. In addition, section three of Resolutions 3605/3628 outlines staff's authority in acquiring and selling port-owned property. The Commission is currently reviewing Resolution 3628 and will consider advisable changes as part of this process, including any revisions to section three related to real property acquisitions and sales. The Commission expects to act on the proposed changes to Resolution 3628 this fall. Port staff members will communicate those changes to the SAO when they have been implemented.

SAO AUDIT RECOMMENDATION 5: Port Commissioners should establish a comprehensive strategy for each real estate asset and operating procedures to ensure prospective transactions are evaluated against those strategies. Specifically, the staff should:

- Develop a written asset management plan and strategies for each real property consistent with the Port's overall real estate strategy.
- Establish and document its desired business terms before negotiations are initiated for large complex transactions.
- Measure, evaluate and document the proposed business terms against whether the property use, lease terms, property improvements and tenant incentives are consistent with the Port's long-term interests.
- Use standardized analytical tools to assess the degree to which the proposed tenancy fits in with the Port's asset management plan.

Port of Seattle Action Status to Recommendation 5:

As noted under Recommendation 1, the Century Agenda process will be completed in 2011, but commissioners adopted the recommended land use and real estate guiding principles in 2009 and currently use those to evaluate real estate transactions. In addition, plans for the port's real estate portfolio are evaluated and approved annually during the budget process. The Port has also evaluated the property assignments between Real Estate and Seaport Divisions, as discussed in response to Recommendation 2, and ensured that properties that support each division's strategic goals are assigned to that division.

Port staff members evaluate management plans for specific assets regularly, through the annual budget planning process, during lease negotiations, and when vacancies occur. As discussed with auditors, the port has specific competitive process and financial analysis expectations for long-term (more than ten years) lease negotiations. Real estate staff members have developed additional policy guidelines for these leases. These guidelines are part of the updated procedures discussed in response to Recommendation 6.

SAO AUDIT RECOMMENDATION 6: Port Commissioners should establish policies and procedures designed to ensure:

- 1) Rental rates reflect fair market value and consistent lease pricing.
- 2) Financial analyses enable the Commission to negotiate acceptable rates of return.

Procedures to set rental rates should require staff members to:

- Treat similar properties consistently and follow the private sector practice of adjusting rental rates over the term of the leases.
- Obtain Commission approval for any lease whose rent does not reflect the prevailing market rate and provide a rationale consistent with the Port's strategic goals and mission.
- Obtain Commission approval for leases that are extended or renewed for combined periods that exceed five years.
- Establish methods to formalize and document the type and frequency of market analyses required for each lease. These methods should address the risks associated with changes in market conditions and over-reliance on third-party brokers.

- Establish a comprehensive marketing strategy that exposes properties to the greatest number of potential tenants.
- Suspend negotiations with a prospective tenant who is unwilling to pay fair market rent, and aggressively market the property to other potential tenants.
- Fully document all lease decisions.

Financial analysis procedures should require Port staff to:

- Prepare financial analyses of leases and capital projects early in the process when internal discussions begin. The financial analyses should consider all costs associated with a given asset so the Port can measure its performance against the asset management plan. The Port should continue to develop, improve and use rigorous, standardized financial analysis tools.
- Prepare a written narrative that describes all relevant facts and assumptions used in the analysis, including the basis for revenue assumptions, tenant selection, land and asset values and evaluation of alternatives.
- Require property managers and analysts to discuss and evaluate alternatives for the use of the land/assets.
- Calculate the projected benefits of the lease using both an "all in" approach (includes new capital expenditures, fair market value of all land and all existing assets, and all lease revenue) and an operational costs-and-revenue approach.
- Develop an independent review system that reports to the Commission. The individual who does this should review and verify information provided to the Commission regarding property transactions. This party would provide in writing:
 - A narrative describing all its relevant facts and assumptions, the method of evaluation, alternatives studied, and the overall conclusion of the financial analysis.
 - An independent review of the financial data prepared by the Division and verification as to its completeness and accuracy for major transactions.
 - A recommendation to approve or reject the proposal.

Port of Seattle Action Status to Recommendation 6:

Rental and lease rates: The direction to establish lease rates that are both consistent and pegged to fair market value seems contradictory; by its nature, fair market value changes often and if lease rates are to be pegged to those fluctuating values, they will not be consistent. Current policy is to consider first, how use of a facility contributes to the port's overall mission of job generation and economic development; and second, how best to achieve the greatest short- and long-term value to the organization for specific properties.

Staff has updated procedures and guidelines to address issues brought up by SAO audit in this area. A copy of the updated procedures is attached. (Attachment 2)

Financial analysis: The port will continue to improve documentation of financial analysis performed for leases that do not require commission approval and of evaluations considered by property management staff, as reflected in the updated procedures referenced above. The port will consistently adhere to policies that provide for written details, reviews, and recommendations of the financial analysis performed. The port will also ensure that commission memos contain a summary of the key components of the analysis performed, while

making more detailed information available to commissioners when requested, as is current practice.

The Port has considered the auditors' recommendation to include an "all in" approach in addition to the current incremental cash flow analysis approach and has elected to continue with its current practice for the following reasons: 1) the incremental cash flow approach is a well-established financial model used widely across both the public and private sectors; 2) the incremental cash flow approach accurately captures all of the relevant costs and benefits of proposed transactions; 3) the evaluation of fair market value is not relevant unless a sale of the property is an alternative under consideration (which is rare under current port policy); and 4) providing more than one financial return calculation would likely cause confusion rather than aid in decision making.

SAO AUDIT RECOMMENDATION 7: To better safeguard its assets and income related to the Seaport's leased cranes, we recommend the Commission revise its procedures to require Port staff to:

- Verify that reported container crane use is accurate. The most practical verification method is to periodically compare longshoreman/operator use data with data reported by the operator through the Seaport Division's Crane billing system.
- Inspect the cranes annually. The Port should consider hiring or contracting for crane specialists to do the inspections if it determines that reprioritizing the current staff's workload will not enable it to do so with current staff.
- Audit crane logs, reports and records of maintenance performed.

Port of Seattle Action Status to Recommendation 7, Crane Billing:

The port is currently updating the automated crane billing process and will use that opportunity to implement additional audit procedures as recommended by the auditors.

Port crane tariffs differ depending on the container terminal. For Terminal 46, the tariff is based upon reported twenty-foot equivalent (TEU) units. For Terminals 5 and 18, the tariff is based upon hours of use. As such, two different methods will be employed.

The port is in the final stages of implementing its Marine Terminal Information System (MTIS). This is a much more robust reporting and customer billing system. A new important feature will be the assignment of a unique identification number used by the terminal operator for inputting data. This unique identifier will allow the port to verify when and by whom the data was input.

The port will assign a specific Seaport employee for audit purposes. Each quarter, a randomly chosen ship at each terminal will be audited. The frequency of the checks may change based on compliance. Audit files will be kept for SAO review.

Terminals 5 and 18: At Terminals 5 and 18, the port will follow the SAO's recommendation to compare longshore data to the terminal operator's report. During load/unload operations, a longshore clerk logs the box moves per crane per shift. The log is then handed in to the terminal operator for entry into the crane billing system.

In that the longshore clerks at these terminals are employed by the Pacific Maritime Association and not the terminal operator, the port feels that this independent source serves as a good validity check to the terminal input.

Terminal 46: At Terminal 46, the port receives daily vessel schedule updates from the terminal. Within the schedule are anticipated box moves. Loaded and unloaded are aggregated to a single number. This pre-arrival information is not entirely accurate as requests to accommodate empty containers are can be made at the last minute. The pre-sail and post-sail data can differ by 100 TEUs. Post-sailing data includes exact figures.

The port will use the post-sailing data and compare it to reported TEU figures in the crane billing system.

Port of Seattle Action Status to Recommendation 7, Crane Inspection: **Regulatory Inspections**

Annual regulatory inspections of the containers cranes will continue to be conducted by the port, utilizing an Accredited Crane Certifier in accordance with the Washington Administrative Code (WAC) 296-56-60093, Certification of Marine Terminal Material Handling Devices. The annual certifications inspect all major crane systems and components and ensure the cranes are in satisfactory condition.

The inspections are documented on the Crane/Derricks work sheet (F416-051-001). Any non-conformance or failures found during the certification inspection are noted on Notice of Deficiencies form (F416-054-000). Corrections of the deficiencies are required before certification is issued. A copy of the Crane Certification forms will be maintained in a centralized location.

Lessee Maintenance

The maintenance procedures for the cranes differ slightly depending upon the manufacturer. As a general rule, cranes receive routine maintenance at regular intervals ranging from daily, weekly, monthly, quarterly, semi-annually to annually, depending on the work performed.

Currently, the three individual lessees have separate practices and procedures for performing and recording these various maintenance functions. A standardized reporting log has been developed for lessees, and they will update these logs as maintenance and inspections are performed. Lessees will be asked to submit an updated log on a quarterly basis. The Lessee Quarterly Maintenance Log will be filed in the same location as the crane certification reports.

Port Inspection and Maintenance Audit

The port will conduct non-regulatory inspections on the individual cranes on a periodic basis. These inspections will utilize the Port Inspection Form and focus on items not typically covered in the annual inspection, such as preventative maintenance, paint, and general housekeeping. The crane maintenance records and reports will be reviewed and compared to the maintenance log information at this time as well.

A three-year cycle will be established for crane inspection and records review. For the 17 port cranes, this schedule means that two cranes will be inspected from each of the three terminals per year, except for Terminal 46, which has five cranes and will have only one crane inspected during one of the cycles. These inspections will be documented on the port inspection form. Any deficiencies identified during the inspection or the record review will be documented and reviewed with the Lessee for correction. The Port Inspection Form and any deficiency documentation will be filed with the other crane documents.

SAO AUDIT RECOMMENDATION 8: To better safeguard its billings and receipts at the Fishermen's Terminal, we recommend the Port:

- Segregate duties to ensure the same employees cannot enter customers, make adjustments to customer accounts, and receipt payments from customers in MMS.
- Require supervisory review of adjustments to customer accounts in the MMS that affect billing rates.
- Restrict access to make adjustments and apply payments to customer accounts to employees who need it as part of their regular job duties. The Port has reports containing vessel length and moorage classification for use when reviewing billing information for accuracy.

Port of Seattle Action Status to Recommendation 8:

Completed. Fishermen's Terminal operates 24 hours a day, seven days a week, and due to the nature of the commercial fishing business, sometimes customers and tenants need to pay bills or conduct other business outside of regular business hours. Because of this, several staff members need to perform key customer service tasks. Nevertheless, in light of auditor recommendations, and pursuant to a port internal audit of Fishermen's Terminal for the operating period 2008 and 2009, the port segregated duties where possible, supervisory review has been strengthened, and system access has been restricted. All Fishermen's Terminal staff will retain the authorization to receive payments due to the nature of the commercial fishing business.

However, no more than three staff members will have the ability to make adjustments to accounts in MMS and all changes to customer accounts in MMS, including those that affect billing rates, are being reviewed manually on a monthly basis by Fishermen's Terminal management. Furthermore, only those employees who adjust and apply payments to customer accounts as part of their regular job duties have access, as well as staff members in the Accounting & Financial Reporting (AFR) and Information & Communications Technology (ICT) departments. Vessel length and moorage classification has been added to MMS/billing reports and is being used when reviewing billing information for accuracy. In addition, possible changes to the Marina Management System (MMS) will be reviewed by ICT and Fishermen's Terminal management.

SAO AUDIT RECOMMENDATION 9: We recommend the Port revise its policies and procedures to establish and enforce safeguards against inappropriate spending. The revised procedures should:

- Limit funding of Port Jobs to programs that are clearly within its legal authority as stated in the 2010 legislation.
- No longer require construction companies to contribute to Port Jobs as part of their construction contracts.
- Ensure its agreements to clearly identify the scope of work and all related deliverables.
- Require Port Jobs and its partners to document all deliverables have been provided before payments are made.
- Disclose to the Port Commission the nature and value of all in-kind support to Port Jobs or other nonprofit organizations. These amounts should be reflected in the Port's agreements with these groups.

- Disallow any organization to operate from Port facilities unless an agreement is in place authorizing them to do so.

Port of Seattle Action Status to Recommendation 9:

Completed. In early 2010, the Washington State Legislature passed legislation clarifying the port's ability to participate in programs such as Port Jobs. The new contract with Port Jobs is clear about the scope of work expected and reflects all in-kind support, and the port's Office of Social Responsibility (OSR) is administering the contracts accordingly. On new construction contracts, companies are no longer required to contribute 20 cents per hour toward the pre-apprenticeship program which was designed to develop a workforce skilled in the trades.

SAO AUDIT RECOMMENDATION 10: We recommend the Port Commission clarify and enforce policies on loss reporting to ensure compliance with state law.

Specifically, the Commission should:

- Amend current Port policies to require all departments to report all known or suspected losses to executive management, the Port's internal auditor and the State Auditor's Office. The policy also should require the Port Police Department to check with these parties to ensure they have been notified when losses are reported to that Department.
- Monitor compliance with Port policies to ensure they are followed.
Use a standard loss reporting form to notify executive management, the internal auditor and the State Auditor's Office.

Port of Seattle Action Status to Recommendation 10:

Completed. In collaboration with the Port's Internal Audit, Legal, Risk Management, Information Technology, and Police departments, the Workplace Responsibility Office has streamlined reporting, communication and documentation procedures. The procedures have been implemented and pertinent sections will be incorporated into a revised edition of the Port's Code of Conduct, which all Port employees will again be required to read and sign in the fourth quarter of 2011. The Workplace Responsibility Office will monitor compliance with the procedures. The Port uses a standard loss reporting form to notify the SAO.