



Internal Audit Report

Lease and Concession Audit
Cruise Terminals of America (CTA)

January 1, 2009 – December 31, 2010

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Transmittal Letter

Audit Committee
Port of Seattle
Seattle, Washington

We have completed an audit of the Lease and Concession Agreement between the Port of Seattle and Cruise Terminals of America (CTA). The purpose of the audit was to determine whether:

- 1) The revenue reported was complete, properly calculated, and remitted timely to the Port.
- 2) The parties complied with significant provisions of the lease and concession agreement.
- 3) Port management oversight of the lease agreement was adequate.

We examined information related to a two-year period from January 1, 2009, through December 31, 2010.

We conducted this audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence that provides a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Cruise Terminals of America did not report gross revenues in accordance with the terms of the lease agreement. We determined that CTA owes the Port \$1,071,034 in underpaid percentage fees, interest, and audit costs. Further, as discussed in the Schedule of Findings, we identified other issues of noncompliance and Port management's failure to properly administer the terms of the agreement.

We extend our appreciation to the management and staff of Seaport Cruise & Maritime Operations, Seaport Finance & Budget, and Accounting & Financial Reporting at the Port for their assistance and cooperation during the audit. We also thank the management and staff of CTA for their assistance during the audit.



Joyce Kirangi, CPA
Director, Internal Audit Department

Executive Summary

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

- 1) The concession revenue was complete, properly calculated, and remitted timely to the Port.
- 2) The parties complied with significant provisions of the lease and concession agreement.
- 3) Port management oversight of the lease agreement was adequate.

This is our second audit of Cruise Terminals of America, LLC (CTA). We examined the books and records for a two-year period from January 1, 2009, through December 31, 2010. Seaport Cruise & Maritime Operations, in conjunction with Seaport Finance & Budget, and Accounting and Financial Reporting (AFR), has the primary responsibility at the Port of Seattle for administering and monitoring the agreement to ensure contractual compliance.

Agreement Terms The concession percentage per Agreement 975 is calculated on two basic fees:

Percentage Fees (Summarized)

- 0% - for gross receipts less than \$400,000
- 73% - for gross receipts greater than \$400,000 but less than \$4.9 million
- 76% - for gross receipts greater than \$4.9 million

The agreement provides a basic set of exclusions from gross revenue including taxes, refunds to customers, and revenue derived from expenses passed directly through to third parties. However, any markup on such pass-through expenses is included in gross revenue.

The agreement further provides for an annual calculation of an expense to gross revenue ratio. The “Agreed Expense Ratio” is 17% of gross revenue and the calculation results in either a savings rent that is returned to the Port or a rent credit that is returned to CTA. When the allowable operating expenses are less than the Agreed Expense Ratio, the Port receives from CTA a Savings Rent of 50% of the amount saved. When the allowable operating expenses are more than the Agreed Expense Ratio, CTA receives from the Port a Rent Credit of 50% of the excess amount.

In addition, when annual Net Operating Income is less than the Minimum Assured Income (\$300,000), CTA is allowed the difference as a credit, which is applied in accordance with the terms of the agreement.

The percentage fee is payable within 15 days after the end of each calendar month with respect to gross revenues realized during the month.

For untimely payments, the agreement provides for a one-time late fee of 5% of the overdue amount and finance charges to be accrued at the rate of 18% per annum from the due date until paid.

Audit Result Summary Cruise Terminals of America did not report gross revenues in accordance with the lease agreement. We determined that CTA owes the Port \$1,071,034 in underpaid percentage fees, interest, and audit costs. Further, as discussed in the Schedule of Findings, we identified other issues of noncompliance and Port management’s failure to properly administer the terms of the agreement.

Background

The Port of Seattle is the owner of the cruise terminals at Piers 66 and 91. Cruise Terminals of America (CTA) has entered into a lease agreement with the Port to lease and operate the cruise terminal facilities, in exchange for which it remits a percentage fee to the Port. The lease agreement establishes a landlord tenant relationship between CTA and the Port.

CTA's owners consist of Columbia Hospitality Inc. (CHI), Stevedoring Services of America Marine, Inc (SSA) and General Steamship Agencies, Inc.

Prior to May 2003, the Port of Seattle had a management services agreement with CTA for management of the Port cruise business at Pier 66. The management services agreement allowed CTA to manage the cruise business on behalf of the Port. The agreement with CTA was later transitioned from a management services agreement to a lease agreement (572).

The cruise business grew quickly in the early 2000s. Within a few years, the Port determined that the assumptions embedded in the terms of the lease agreement warranted revision.

In 2005, the Port and CTA entered into a revised lease agreement (975) that provided more financial benefits to the Port of Seattle in exchange for an extended lease term to CTA. The timelines of the agreements between the Port of Seattle and CTA are as follows:

Description of Agreement	Date Executed	Term Ends	Extension Option Until
Management Agreement	Late 1990s	April 2003	N/A
First Lease Agreement 572	April 2003	December 2005	N/A
Second Lease Agreement 975	January 2006	December 31, 2012	December 31, 2019
First Amendment to 975	May 2006	December 31, 2012	December 31, 2019

The members of the Port of Seattle's original management oversight team for the CTA agreement transitioned after the negotiation and execution of the second lease agreement. Two of the key managers involved in the lease negotiations left the Port in 2006; only one manager remains part of the current team charged with oversight of the CTA agreement.

In 2008, Internal Audit conducted a limited scope review of the CTA management services agreement with the Port. The primary objective was to ensure that Port funds were promptly returned to the Port when the management services agreement ended. Under that limited review, we also briefly assessed the effectiveness of Port management's monitoring controls over the CTA lease agreements. The report was issued in 2009, and it noted that Port management's monitoring system was inadequate. This is our second audit of the Cruise Terminals of America, LLC (CTA) agreement with the Port. In this audit, we examined the books and records for a two-year period from January 1, 2009, through December 31, 2010.

Seaport Cruise & Maritime Operations, in conjunction with Seaport Finance & Budget, and Accounting and Financial Reporting (AFR), has the primary responsibility at the Port of Seattle for administering and monitoring the agreement to ensure compliance by CTA.

The concession percentage per Agreement 975 is calculated on two basic fees:

Percentage Fees (Summarized)

- 0% - for gross receipts less than \$400,000
- 73% - for gross receipts greater than \$400,000 but less than \$4.9 million
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The agreement provides a basic set of exclusions from gross revenue including taxes, refunds to the customers, and revenue derived from expenses passed directly through to third parties. However, any markup on such pass-through expenses is included in gross revenue.

The agreement further provides for an annual calculation of an expense to gross revenue ratio. The “Agreed Expense Ratio” is 17% of gross revenue and the calculation results in either a savings rent that is returned to the Port or a rent credit that is returned to CTA. When the allowable operating expenses are less than the Agreed Expense Ratio, the Port receives from CTA a Savings Rent of 50% of the amount saved. When the allowable operating expenses are more than the Agreed Expense Ratio, CTA receives from the Port a Rent Credit of 50% of the excess amount.

In addition, when annual Net Operating Income is less than the Minimum Assured Income (\$300,000), CTA is allowed the difference as a credit, which is applied in accordance with the terms of the agreement.

The percentage fee is payable within 15 days after the end of each calendar month with respect to gross revenues realized during the month.

For untimely payments, the agreement provides for a one-time late fee of 5% of the overdue amount and finance charges to be accrued at the rate of 18% per annum from the due date until paid.

Three-year Financial Highlights

Revenue

Year	Reported Gross Revenue	Percentage Fee
2008	\$12,280,187	\$9,384,994
2009	12,413,916	8,995,576
2010	13,659,453	9,942,185

Source: PropWorks and PeopleSoft

Allowable Expenses Used in the Calculation of Agreed Expense Ratio (17%)

Year	Reported Allowable Expenses	Savings Rent Reported & Paid to the Port
2008	\$1,307,613	\$390,009
2009	1,379,807	365,280
2010	1,625,795	348,156

Source: CTA annual reports

Audit Objectives

The purpose of the audit was to determine whether:

- 1) The concession revenue was complete, properly calculated, and remitted timely to the Port.
- 2) The parties complied with significant provisions of the lease and concession agreement.
- 3) Port management oversight of the lease agreement was adequate.

Audit Scope and Methodology

The scope of the audit covered the period January 1, 2009, through December 31, 2010.

We determined whether:

- The lessee was in compliance with the lease agreement terms including, but not limited to, proper concession payments. The audit approach was risk-based from planning to test sampling. We applied additional detailed audit procedures to areas with the highest likelihood of significant negative impact as follows:

- | | |
|----------------------------------|--------------------------------|
| a. Timely Payment | g. Minimum Rent Income |
| b. Insurance Liability | h. Allowable expenses |
| c. Surety Bond/Security Deposit | • Capital allowance |
| d. Certified Annual Report | • Tenant improvement allowance |
| e. Percentage/Concession Revenue | • Maintenance allowance |
| f. Savings Rent/Credits | |

a. **Timely Payment**

We reviewed payment records to determine whether the lessee complied with the timely payment requirement.

b. **Insurance Liability**

We determined whether insurance requirements had been met by reviewing the certificates of insurance in force for the audit period.

c. **Surety Bond/Security Deposit**

We reviewed and agreed surety requirements as stipulated in the agreement to documentation submitted by the lessee to determine compliance.

d. **Certified Annual Report**

We reviewed the annual certifications for the audit period to determine whether the certifications were submitted timely.

e. **Percentage/Concession Revenue**

We obtained a detailed trial balance and summarized a profit and loss statement by category.

We agreed the auditor's profit and loss statement to the actual monthly percentage reported and paid to the Port from January 1, 2009, through December 31, 2010. We verified that CTA's revenues were properly included or excluded from the gross revenue as defined by the lease agreement. We selected three months from the audit period, obtained detailed schedules of revenues, and traced the revenue to the cash receipts journals. We selected 25 detailed revenue items (from the detailed general ledger schedule) that were included in gross revenue in each month, and obtained support to determine proper inclusion and/or exclusion as stipulated in the agreement-- per Section 1.20. We recalculated the percentage rent as defined in the lease agreement and reconciled to the monthly rent report and remittance of funds recorded in the cash disbursement journal.

f. **Savings Rent or Rent Credits**

We verified that expenses were properly included or excluded in the allowable expenses as stipulated in the agreement. We selected four months from the high season and obtained detailed schedules of expenses and compared to the cash disbursements journal. We selected for testing over 440 detailed transactions of allowable expenses that we deemed high risk. We obtained supporting records and determined proper inclusion or exclusion as stipulated in the lease agreement -- Section 1.5. We traced the expenses to the cash disbursements journal.

We recalculated the agreed expense ratio and agreed the amount reported in the 2009 and 2010 financial reports, in order to determine whether allowable expenses, when expressed as a fraction of gross revenue, were less or more than the agreed expense ratio (17%).

g. **Minimum Rent Income**

We verified whether the annual net operating income was greater than the minimum assured income (\$300,000). We recalculated the credit and traced to the monthly rent reports.

h. **Allowable Expense (Capital, Tenant Improvement, Maintenance Allowance)**

We obtained detailed job costs of capital, tenant improvement, and maintenance allowance from the Port of Seattle, Marine Maintenance Department. We traced from the detailed job costs to lessee's accounts receivable clearing account and to Port reimbursement.

- Management oversight of the CTA agreement was adequate.
 - We gained an understanding of Port managers' roles and oversight of the CTA agreement.
 - We determined the time periods during which managers were responsible for the oversight.
 - We determined Port managers' understanding of the requirements in the agreement with CTA.

Conclusion

Cruise Terminals of America did not report gross revenues in accordance with the lease agreement. We determined that CTA owes the Port \$1,071,034 in underpaid percentage fees, interest, and audit costs. Further, as discussed in the Schedule of Findings, we identified other issues of noncompliance and Port management's failure to properly administer the terms of the agreement.

Schedule of Findings and Recommendations

1. Cruise Terminals of America (CTA) Did Not Report Gross Revenues In Accordance With the Lease Agreement

CTA reported parking revenues to the Port net of the related expenses. Based on the terms of the lease agreement, revenues are supposed to be reported at gross, not net. This misapplication of the terms of the lease agreement resulted in fees paid to the Port that were lower than owed.

Fees to the Port are calculated based on percentages of gross revenue tiers. The agreement further provides for calculation of an expense to gross revenue ratio, which results in either a rent savings that is returned to the Port or a rent credit that is returned to CTA.

Below is a summary of gross revenue and related fees reported by CTA and the audited amounts:

Year	Reported by CTA		Audited Amounts				Total Understatement to the Port
	Gross Revenue	Percentage Fees	Gross Revenue	Percentage Fees	Under Reported Fees	Rent Credits Due to CTA	
2009	12,413,916	8,995,576	13,203,629	9,595,758	600,182	(319,582)	280,600
2010	13,659,453	9,942,185	14,867,726	10,860,472	918,287	(499,119)	419,168
Total Fees Underpaid to the Port							699,768
Interest Charged as of December 6, 2011							346,313
Audit Cost per Section 4.8.2 (408 hours plus benefits)							24,953
Grand Total							\$1,071,034

The lease agreement defines gross revenue as follows (Section 1.20):

*“...the aggregate **gross amount of revenue** derived in, on or about the Premises for from Tenant’s operations, and whether: (i) in cash, on credit or in kind, (ii) at wholesale, at retail or otherwise, and (iii) transacted by Tenant, by any persons, firms or corporations on Tenant’s behalf, or by any subtenants, licensees or concessionaires of Tenant (specifically including any Parking Operator), from, in or upon the Premises...”*

Recommendations

We recommend Port management:

1. Recover approximately \$1,071,034, which includes underpaid percentage fees, interest, and audit costs as shown in the table above.
2. Ensure that CTA complies with the lease agreement definition of gross revenues and allowable operating expenses.
3. Review agreement years 2006, 2007, 2008, and 2011 for the correct reporting of gross revenues and recover underpaid fees, if applicable

Management Response

Management concurs with the audit finding that the tenant did not report Gross Revenue and Allowable Operating Expenses in accordance with the lease. As a result, percentage rent remitted to the Port was lower than the amount due under the lease for the two year audit period (2009-2010).

Management will work with the tenant to recover all rent, interest, and audit fees due to the Port in accordance with the lease. In this effort, Management intends to review prior year tenant reporting retroactive to the inception of the current lease (2006) to ensure reporting of parking revenue and parking expenses are in compliance with lease requirements and to recover additional unpaid rent, if applicable.

Management will continue to reinforce the tenant's responsibility for maintaining true and accurate records in compliance with the lease.

2. CTA Did Not Fully Comply With Its Lease Agreement With The Port Of Seattle And Certain Multi-tier Service Arrangements Hindered The Port's Understanding Of Parking/Shuttle Costs

The Port of Seattle is the owner of the cruise terminals at Pier 66 and Terminal 91. The Port entered into an agreement with Cruise Terminals of America (CTA) to lease and operate the cruise terminals, including the Terminal 91 parking area. Equity owners of CTA are Columbia Hospitality Inc. (CHI), SSA Marine, Inc (SSA) and General Steamship Agencies, Inc.

The relevant provisions of the agreement in relation to the issues cited herein are as follows:

Section 1.5.14 of the Lease Agreement between the Port and CTA states that allowable expenses shall **not** include:

"...any amounts paid to an affiliate or Qualifying Person (other than bona fide cost of compensation specifically allowed by Section 1.5.3) unless expressly approved, in advance in writing, by the Port..."

Section 1.2 of the Lease Agreement defines affiliate as follows:

Affiliate shall mean and refer to any person that, directly or indirectly, (i) is owned by (ii) owns, (iii) shares common ownership with, (iv) is controlled by, (v) controls, or subject to common control with any Qualifying Person.

Section 1.46 of the Lease Agreement states that a Qualifying Person shall mean and refer to:

"...Any equity interest owners of Tenant (including SSA Marine, Inc., General Steamship Agencies, Inc., and/or Columbia Hospitality, Inc.)

Section 8.1.8 of the Agreement provides for parking:

"Tenant may select a parking operator to operate the parking and undertake all parking operations and/or parking services...subject to the Port's reasonable approval."

CTA has an agreement with Republic Parking Northwest (Republic) for the operation of the parking facility at Terminal 91. It states:

"The Agreement shall not be assigned nor subcontracted in whole or in part without the written consent of [CTA]..."

Further, the Port's agreement with CTA states:

"This agreement sets forth all covenants, promises, agreements, conditions, and understanding between the Port and Tenant concerning the Premises... No subsequent alteration, change or addition to the Agreement shall be binding upon the Port or Tenant unless reduced to writing and signed by the Port and Tenant..." (Section 22.15)

"The failure of the Port to insist in any one or more instances, upon a strict performance of any of the covenants of this Agreement, or to exercise any option herein contained, shall not be construed as a waiver of or relinquishment for the future of the performance of such covenant..." (Section 20.2)

“...No act or omission of any officer, employee or agent of the Port...shall alter, change or modify any of the provisions hereof...” (Section 22.14)

When cruise operations moved from Terminal 30 to Terminal 91 in 2009, it became necessary to provide shuttle services from the terminal to the parking facility. Republic began providing the shuttle services in April 2009. However, in July 2009, SSA, an equity owner of CTA, assumed responsibility for shuttle services at Terminal 91 and billed its services to Republic.

CTA arranged for SSA, an affiliate, to “subcontract” with Republic Parking. However, CTA did not authorize in writing this arrangement between Republic and SSA, which did not comply with its management agreement with Republic.

The flow of costs was as follows: (1) SSA billed Republic for its shuttle services. (2) Republic paid SSA and submitted the costs to CTA. (3) CTA passed these costs through to the Port of Seattle. The arrangements for SSA to provide shuttle services were not transparent.

SSA was paid approximately \$440,000 and \$1 million in 2009 and 2010, respectively, for shuttle services. The amount paid to SSA in 2011, for shuttle services, is estimated to be about \$900,000.

By SSA providing shuttle services under the scope of work in this agreement, CTA was required under its agreement with the Port to obtain advance approval in writing from the Port, because SSA is a “Qualifying Person” (i.e., a related party) and such expenses are not allowed unless expressly approved by the Port.

For the two months in 2009 that Republic operated the shuttle, the hourly rate charged and billed to CTA was \$80 (including Republic’s cost of shuttle bus rental). The average hourly rate Republic paid to SSA in 2009 was \$112 (including a fee charged by SSA to recover the cost of five buses). These rates were not apparent in CTA’s reports to the Port of Seattle and, therefore, Port management could not determine whether they were reasonable.

Parking shuttle services expense increased significantly from approximately \$500,000 in 2009 to over \$1 million in 2010. These expense increases resulted in rent credits owed by the Port to CTA. As described in Finding 1, the concession fee that CTA remits to the Port is calculated based on percentages of gross revenue tiers. The agreement further provides for calculation of an allowable expense to gross revenue ratio (Agreed Expense Ratio). If expenses decrease below the agreed ratio, the Port realizes a rent savings; if expenses increase above the agreed ratio, CTA realizes a rent credit. Parking operating expenses are included in this ratio calculation.

The multi-tier contractual arrangements in which CTA engaged led to a lack of transparency and may have contributed to paying an affiliated party (SSA) for parking shuttle services, which did not comply with the terms of the lease agreement. Also, because of the lack of transparency, Port management appears not to have fully comprehended the implications of the increased costs for shuttle services provided by SSA. As stated in Finding 1, CTA netted parking expenses against gross revenues when reporting to the Port. This inappropriate netting of expenses

against revenue prevented Port management from seeing and analyzing the shuttle services costs.

Recommendations

We recommend Port management:

1. Develop an improved process for monitoring CTA's compliance with the terms of its lease agreement with the Port.
2. Consider disallowing parking shuttle services paid to SSA because SSA is an affiliate of CTA. Per the agreement, any payment to an affiliate or related party is not allowed unless approved in advance and in writing by the Port.
3. Ensure that CTA complies with the terms of its agreement with the Port and obtains written consent for any scope of work that is contracted or provided by an affiliated party.

Management Response

Management concurs with the audit finding that multi-tier contractual relationships do hinder full transparency of operating costs – including costs related to parking shuttle services, of which the tenant is obligated to provide under the lease agreement.

Management will work with the tenant to ensure all known affiliate relationships are properly documented and administered in compliance with the lease. In addition Management will work with Port counsel to determine if additional rent is owed to the Port due to unqualified payments made to affiliates of CTA, in the absence of the required advance written approval.

As noted in the audit finding, the cost for parking shuttle services at Terminal 91 was significant in 2009 and increased again in 2010. It was also noted that effective in July 2009, Stevedoring Services of America (SSA), assumed the responsibility of performing parking shuttle services at Terminal 91. Management feels it would be helpful to provide some background information related to this change in parking operations in order to facilitate a better understanding of the labor issue at Terminal 91:

Background Information:

Under the terms of the lease agreement between the Port and CTA, the tenant shall engage the stevedoring services provider for all terminal handling. The stevedoring services, provided to the cruise lines to support each vessel call, which include line handling, equipment, labor and the movement of luggage and stores/ship provisioning, are billed directly to the cruise lines. CTA has designated SSA as the stevedore for cruise terminal operations at both P66 and P91.

Prior to the opening of the new cruise terminal at T91 in 2009, Union members of Local 19 International Longshore and Warehouse Union (ILWU)--a labor union which primarily represents dock workers on the West Coast of the United States--had claimed to their employer SSA, that because T91 was considered to be a new cruise terminal and under the ILWU West Coast Labor Bargaining Agreement, certain work at

the new terminal belonged to them. Through discussions between SSA and ILWU Local 19, of which the Port did not participate, an agreement between SSA and Local 19 was reached regarding which labor activities would be performed by ILWU labor. All parking shuttle operations in support of the new cruise terminal operation at Pier 91 were determined to be ILWU work. In July of 2009 Port management was verbally informed by CTA of this change and that SSA would be providing parking shuttle services and would be billing Republic Parking for these services.

3. Port Management Did Not Properly Administer The Terms Of The CTA Agreement

In the late 1990s, the Port of Seattle entered into a management services agreement with Cruise Terminals of America (CTA), to develop the cruise business at the Port of Seattle. The management services agreement allowed CTA to manage the cruise business on behalf of the Port.

CTA's owners consist of Columbia Hospitality Inc. (CHI), Stevedoring Services of America Marine, Inc (SSA), and General Steamship Agencies, Inc.

In 2003, the Port transitioned the agreement with CTA from a management services agreement to a lease agreement (572). The lease agreement establishes a landlord tenant relationship between CTA and the Port. The cruise business grew quickly in the early 2000s, and within a few years the Port determined that the assumptions embedded in the terms of the lease agreement warranted revision.

In 2005, the Port and CTA entered into a revised lease agreement (975) that provided more financial benefits to the Port of Seattle in exchange for an extended lease term to CTA.

The terms of the CTA lease agreement are complex, unique, and have changed multiple times. Further, the majority of the original Port managers who negotiated and established the terms of the current lease structure have left the Port or transitioned into other roles.

In 2008, Internal Audit conducted a limited scope review of the CTA management services agreement. The primary objective of the review was to ensure that Port funds were promptly returned to the Port when the management services agreement ended. Under that limited scope audit, we also briefly assessed the effectiveness of the Port management monitoring controls over the CTA agreements. The report was issued in 2009, and it noted that Port management's monitoring system was inadequate.

In response to the Internal Audit report, Port management required CTA to implement the following process improvements:

- Certify the accuracy of each month's financial reports
- Hire an independent CPA to conduct an annual verification of financial reporting accuracy

For the current CTA lease audit, we determined that Port management failed to identify and correct two significant issues of non-compliance by CTA. However, nothing came to our attention to indicate intentional wrongdoing by any of the Port staff we interviewed or audited.

- Contrary to the terms of the lease agreement, CTA reported parking revenues to the Port net of the related allowable expenses. Based on the terms of the lease agreement, parking revenues were required to be reported at gross, not net. (See Finding 1)
- Without express approval by the Port, as required by the agreement, payments for shuttle services were made to an affiliated party. (See Finding 2)

As a result of the above non-compliance:

- The Port received a significantly lower fee than it was due, because CTA underreported revenue.
- When the shuttle services transitioned from Republic to SSA, the expense of shuttle services increased significantly, which required the Port to owe rent credits to CTA.

Management's failure to identify and correct these issues is attributable to the following:

- Management did not institute an adequate monitoring process commensurate with the complex terms of the lease agreement.
 - Given the complexity of the CTA agreement and the management transitions, knowledge transfer may have been inadequate. In other words, issues that might have been obvious to longer-term managers may not have been clear to the newer managers.
 - Financial analysis of the cruise business operation management is performed primarily by one manager, and the analysis missed significant non-compliance by CTA. The division team overseeing the CTA agreement had not implemented an effective monitoring system to detect such an oversight. As a result, the non-compliance occurred for a long time.
- Compliance monitoring, although performed, was not always properly applied.

For example:

- Port management was aware that the lease agreement required parking revenue to be reported at gross (not net of expenses). Further, Port management knew that parking expenses would increase during 2009 and 2010, due to the additional costs for shuttle services at Terminal 91. Despite such knowledge, Port management did not detect the errors in the financial reports submitted by CTA. The following is an excerpt from the monthly CTA reports, which clearly shows declining parking revenues and minimal parking expenses. The reported amounts displayed “red flags” that should have alerted Port management that revenue and expenses were not presented in accordance with the terms of the agreement:

2009	March	May	June	July	August	September	Total
Parking Revenue			166,237	31,309	31,867	18,254	247,667
Non-Cruise Expense (includes parking)	80		74			1,452.	1,606
2010	March	May	June	July	August	September	Total
Parking Revenue		(12,938)	(61,154)	(31,602)	105,695		-
Non-Cruise Expense (includes parking)	95		2,962			198	3,256

Excerpt from CTA Financial Reports

- Management was aware that SSA was one of the CTA owners and that SSA was providing shuttle services to Republic at Terminal 91. However, Port cruise business operation management did not question whether the relationship might fall under the affiliate (related party) prohibition of Section 1.5.14 of the agreement.
- Port management may have over relied on processes it put into place in early 2009. For example, Port management had required CTA to implement the following process improvements:
 - Certify the accuracy of each month's financial reports
 - Hire an independent CPA to conduct an annual verification of financial reporting accuracy

Although these measures were intended to ensure financial reporting accuracy, neither measure identified the errors cited in Finding 1.

Recommendations

We recommend Port management:

1. Ensure that transitions in Port management are carefully orchestrated to avoid knowledge vacuums.
2. Develop a compliance checklist of the major lease requirements in order to guide and supplement the review process.
3. Design and implement effective monitoring and oversight controls that will help detect reporting errors in a timely manner.
4. Consider whether it might be more effective for Port management to conduct periodic inspections of the CTA accounting records.

Management Response

1. Ensure that transitions in Port management are carefully orchestrated to avoid knowledge vacuums.

Management administered a level of transitioning that was commensurate with the capabilities of employees fulfilling the roles. The CTA Lease transitioned to proven high performers that were highly experienced, skilled, and capable people, exhibiting high attention to detail. However, the gross vs. net revenue error may have been avoided with a collaborative group review (including personnel from business operations, Seaport Finance, and CTA) of the CTA Monthly Financial Report. Management intends to commence such meetings effective immediately.

2. Develop a compliance checklist of the major lease requirements in order to guide and supplement the review process.

Management agrees and will develop a compliance checklist to bolster the thoroughness of the review process.

3. Design and implement effective monitoring and oversight controls that will help detect reporting errors in a timely manner.

Both Seaport business operations and finance staff are responsible for review and oversight of the CTA agreement. Business operations staff is responsible for lease administration and Seaport finance provides financial expertise. To strengthen effectiveness of monitoring and oversight controls, management intends to implement collaborative group meetings as proposed in our response to Recommendation 1, and the additional measures as described in our response to Recommendation 4.

4. Consider whether it might be more effective for Port management to conduct periodic inspections of the CTA accounting records.

Management has given thoughtful consideration to conducting periodic inspections of CTA accounting records. Since Seaport is not staffed for inspecting accounting records and such inspections are more effectively and efficiently performed by an appropriately credentialed auditor, management proposes to strengthen the audit of CTA accounting records, as follows:

- a. *Review and expand the current scope of work performed by the independent CPA hired by CTA to conduct an annual verification of financial reporting accuracy. This expanded scope of work may include an annual briefing of audit findings to Port/CTA staff, sample size adjustment, more thorough drill-down into reporting categories to assure compliance with lease, and/or similar.*
- b. *Expand the reporting requirements of CTA so that compliance with key elements of the lease are more easily monitored, and increase effectiveness of review as described in our response to Recommendation 1.*
- c. *Continue periodic reviews performed by Internal Audit as an additional check and balance to the financial controls noted above.*