

## Is The Port of Richmond Underwater?

*The Port had total deficit net asset of \$1.3 million as of June 30, 2011 ... The Port reported an operating income of \$3.1 million at the end of the fiscal year as the result of increased lease income. However the Port also reported deficit non-operating expenses of \$3.2 million due to interest expense incurred in conjunction with the Series 2009A and 2009B Point Potrero Lease Revenue Bonds that were issued to fund construction at the Port.*

*2011 Comprehensive Financial Report, Richmond, California*

*The Port's mission is "...to obtain the maximum financial benefit to the City."*



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## Executive Summary

Far from being the economic engine that it is popularly portrayed by its boosters, the Port of Richmond is continuing a 110-year tradition of mismanagement and losses that have dogged it since 1901.<sup>1</sup>

The Port's mission is:

The Port of Richmond is responsible for developing, marketing, leasing, operating, and maintaining all City-owned marine terminals to obtain the maximum financial benefit to the City. The Port Department performs its function through two divisions: Administration and Operations. 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.<sup>2</sup>

"...obtain the maximum financial benefit to the City." Currently, despite ambitious capital projects and rosy projections, the Port of Richmond is losing money, and the end is nowhere in sight. This is not just a cash flow problem resulting from the still sluggish economy; it is also a management problem. A recent audit ordered by the city manager and completed on June 28, 2011, found the Port to be deficient in all twelve operational aspects reviewed.

The audit forecasts an operating deficit totaling nearly \$3 million over the next three years, and the port still owes the City's general fund over \$17 million advanced in the past for unsuccessful infrastructure investments.

Contrary to the belief of many, the Port of Richmond is not an independent agency. It is simply a department of the City of Richmond, under the policy direction of the City Council and the operational direction of the city manager through the port director, Jim Matzorkis.

For years, the Port has enjoyed autonomy unique among City departments, protected and insulated by City Council majorities and a string of city managers fearful of offending their bosses. The myth of the Port as a powerful job producer and economic activity generator has been swallowed whole, supported by the Chamber of Commerce and Council of Industries. Only recently has this cozy arrangement been successfully and politically challenged.

The Port has focused on large capital projects and incurred debt that exceeds its ability to service it. The Honda Port of Entry Project spent \$14 million for infrastructure on BNSF property and got nothing in return. The Port received \$14 million in federal security projects and spent \$3 million on a video surveillance system that doesn't work.

Port Director Jim Matzorkis has spend over \$30,000 on so far fruitless trips to China trying to convince a Chinese electric car manufacturer to import cars through Richmond to compete with electric cars being built in California by California workers. What is wrong with this picture?

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<sup>1</sup> See [http://www.tombutt.com/pdf/port\\_1901-1980.pdf](http://www.tombutt.com/pdf/port_1901-1980.pdf)

<sup>2</sup> 2011-2012 City of Richmond Budget Document

This is not to say that the Port doesn't have a productive role to play in Richmond. It does. But the Port needs to meet the same expectations of transparency and productivity expected from other City departments. And the city manager needs to exercise the same level of authority over the Port as with other City departments.

To be fair, the Port has hired two additional staff members following the 2011 audit and claims to have addressed all of the deficiencies pointed out in the audit except those related to property management.

In the mid-year 2011-2012 Budget Review, the Port of Richmond projected revenue of \$21,991,615 and expenses of \$23,929,058, a significant loss. The Budget Review document notes, "Subaru and interest income was less than expected."

## What is the Port of Richmond?

The operational components of the Port of Richmond consist of only three waterfront sites totaling 158 acres of land, identified as Terminal 2, Terminal 3 and Point Potrero Marine Terminal (PPMT). Former Terminals 1 and 4, consisting of 61 acres, are still owned by the City of Richmond but are no longer operational for port use.

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.

- **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.
- **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.

The Port is considered an "enterprise" operation of the City, meaning that it is intended to be at least self supporting and, ideally, to produce surplus revenue that can be used for other purposes. For most of the recent decades, the Port has operated at a loss or at best, a modest profit.

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."<sup>3</sup>

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<sup>3</sup> Internal Audit of Port of Richmond, Kevin W. Harper CPA & Associates, June 28, 2011, 13

The fact is that the Port of Richmond has been a loser for over a hundred years. A classic study by the League of Women Voters, with Lucretia Edwards as principal author, published *Port of Richmond 1901-80* in 1980, detailing how one slick operator after another took the City fathers to the cleaners.

Tracking Port finances year to year is challenging because operational income and expenses are lost in a mishmash of government Homeland Security infrastructure grants, massive capital expenditures on operations infrastructure (The Honda Port of Entry Project) and interest on financing for infrastructure capital improvements. The operating strategy for the Port for years has been to negotiate leases based on the Port's financing and construction of necessary infrastructure. While the gross income from such operations tends to appear impressive, it is typically substantially reduced by debt service to pay for those improvements.

According to the audit, the Port showed an operating surplus during three of the last four years and a loss for FY 2009-10:<sup>4</sup>

- 2006-07           \$2,377,595
- 2007-08           \$1,956,067
- 2008-09           \$718,335
- 2001-10           (\$518,860)

Factoring in the complexity of grants, debt service and capital projects, the Port ended fiscal years in the red two of the last four years:<sup>5</sup>

- 2006-07           (\$2,654,697)
- 2007-08           \$3,306,727
- 2008-09           \$3,852,139
- 2001-10           (\$1,232,048)

The Port landed a contract to import Kias and Hyundais in 2004, and Terminal 3 was relatively busy handling cars shuttled to Hawaii, but both businesses left in 2009-2010. Hondas and Subarus have replaced Kias and Hyundais at PPMT, but Terminal 3 is vacant. The City general fund had to loan the broke port \$750,000 in 2010-2011 to make improvements required to bring in Subaru.<sup>6</sup>

The future doesn't look much better. According to the audit, the Port will have an operating deficit three of the next five years, including 2010-11:

- 2010-11           \$1,452,591
- 2011-12           \$694,426
- 2012-13           \$(193,454)
- 2013-14           \$(1,496,210)
- 2014-14           \$(1,222,966)

<sup>4</sup> Internal Audit of Port of Richmond, Kevin W. Harper CPA & Associates, June 28, 2011, 4

<sup>5</sup> Internal Audit of Port of Richmond, Kevin W. Harper CPA & Associates, June 28, 2011, 14

<sup>6</sup> Internal Audit of Port of Richmond, Kevin W. Harper CPA & Associates, June 28, 2011, 5

Much of the projected losses are a result of debt service for the Honda Port of Entry project and failure to find a lessee for Terminal 3.

In the 1970s, the City floated \$22.8 million in bonds to build Terminal 3 and purchase container cranes. The project never made money, and the City's general fund was forced to subsidize the debt service, resulting in a debt that amounted to \$17,139,855 in 2005. The Port was supposed to pay down the debt at the following rates:<sup>7</sup>

- 2006-07           \$50,000
- 2007-08           \$6,350,00
- 2008-09           \$2,000,000
- 2009-10           \$2,000,000
- 2010-11           \$2,000,000
- 2011-12           \$2,000,000
- 2012-13           \$2,000,000
- 2013-14           \$2,000,000
- 2014-15           \$689,855

However, the Port has paid back only \$100,000 while accruing an additional \$397,525 in interest. As of the end of FY 2011-2011, the Port still owed the general fund \$17,437,380.

## Organizational Structure

Many larger ports are organized as autonomous or semi-autonomous agencies, typically governed by boards selected by legislative bodies. For example, the governing board of the Port of Oakland is nominated by the mayor and confirmed by the City Council.

Over the past decades, discussions about moving to an autonomous port model for Richmond have emerged from time to time as a proposed cure for whatever ails the Port. The 2011 audit noted:

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.

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<sup>7</sup> Internal Audit of Port of Richmond, Kevin W. Harper CPA & Associates, June 28, 2011, 10

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.

The lack of autonomous port governance has been and continues to be a handy excuse for underperformance by the Port. There is no evidence, however, that an autonomous Port would have any advantage in upgrading infrastructure or that Port infrastructure needs are "delayed as more pressing social needs are addressed." In fact, the opposite is true. The Richmond general fund has propped up the Port for years, providing money for infrastructure on the premise that the return on its investment can later be used for pressing social needs. That return, however, has never materialized. The fact is that the Port of Richmond has enjoyed an unusual level of autonomy for years simply because a majority of the City Council has given the port director *de jour carte blanche*, and the city manager *de jour* has carried out the City Council majority's wishes. For at least the last four decades, the port director has been politically untouchable.

While I don't agree with the auditor's recommendation about an autonomous port authority, the recommendation for management might be well considered in the light of the management failures that will be described herein.

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.

## Property Management

The Port of Richmond does not conduct any operations of its own. It is simply a landlord that manages property, but ironically, property management is the Port's greatest weakness, as we shall see in more detail later.

The 2011 audit recognizes this obvious shortfall:

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.<sup>8</sup>

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<sup>8</sup> Internal Audit of Port of Richmond, Kevin W. Harper CPA & Associates, June 28, 2011, 14

While most professional property owners have some idea what their property is worth and periodically measure their investment return on either the market value or the invested value of the asset, the Port has no idea. The 2011 audit recognized this:

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.<sup>9</sup>

The 2011 audit also suggested the use of public-private partnerships to finance capital projects.

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.<sup>10</sup>

Since 2007, beginning with Resolution 100-07 of September 11, 2007, and most recently Resolution 16-11 of March 1, 2011, the City Council has adopted three resolutions making the same recommendation, but the Port has failed to act.

The pattern of the Port has been just the opposite. The Port typically negotiates a lease with a potential tenant conditioned on the Port making large capital improvements financed by debt. The tenant has no skin in the game, and the income from the lease typically barely covers the debt service, if at all.

## Port Debt

The 2011 audit had a lot to say about Port debt to the general fund but was unable to unearth the source of it.

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).<sup>11</sup>

Unfortunately, the Port's institutional memory is short. The original source of much of that debt was the construction of Terminal 3 and purchase of the container cranes in the late 1970's. The general fund ultimately had to bail the Port out for these and other later capital improvements because Port cash flow was insufficient to service the bonded debt.

<sup>9</sup> Internal Audit of Port of Richmond, Kevin W. Harper CPA & Associates, June 28, 2011, 13

<sup>10</sup> Internal Audit of Port of Richmond, Kevin W. Harper CPA & Associates, June 28, 2011, 14

<sup>11</sup> Internal Audit of Port of Richmond, Kevin W. Harper CPA & Associates, June 28, 2011, 15



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.<sup>12</sup>

The auditor does, however, have a point in recommending cleaning up the loan. The Port is, after all, just a department of the City. Carrying the loan on the books makes no more sense than if the City had loaned money to rehabilitate City Hall and expected to recoup it with rent. For all practical purposes, whatever money the City loaned is gone, and the Port's ability to ever pay it back, with interest, is questionable. At the end of the day, if the Port ever turns a profit, the City Council has the prerogative to move money from the Port account back into the general fund.

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.

## Layberthing

In its perilous financial condition, the Port should be pursuing all potential sources of income. After all, the Port's mission is "...to obtain the maximum financial benefit to the City."

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<sup>12</sup> Internal Audit of Port of Richmond, Kevin W. Harper CPA & Associates, June 28, 2011, 15

The 2011 audit, however, pointed out that the Port has not been aggressive in pursuing layberth revenue because it never developed a Coast Guard approved security plan

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.<sup>13</sup>

As it turns out, however, the Coast Guard had waived the requirement for a security officer, and the Port says it is now complying with Resolution 18-98.<sup>14</sup> Why the Port had to wait for an audit to point out this lost opportunity is troubling.

## Tenant Agreements

Being an effective landlord is the core responsibility of the Port, yet the Port failed in many respects to exercise this responsibility effectively and prudently. Here is what the 2011 audit found:

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

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<sup>13</sup> Internal Audit of Port of Richmond, Kevin W. Harper CPA & Associates, June 28, 2011, 16-17

<sup>14</sup> Port of Richmond Internal Audit Report, Recommendations and Actions, September 20, 2011, 2-3

“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.<sup>15</sup>

## Financial Reporting

Part of the Port’s ineptness in the handling and accounting for money can be blamed on jumbled and inconsistent accounting practices and serious reporting errors. The audit concluded that 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” and “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.”

The 2011 audit noted the inconsistencies and uncovered numerous errors:

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.

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<sup>15</sup> Internal Audit of Port of Richmond, Kevin W. Harper CPA & Associates, June 28, 2011, 17

- 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.

## Security Deposits

The Port has failed to collect security deposits from two-thirds of tenants, another core responsibility of a prudent and effective landlord. The 2011 audit reported:

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.<sup>16</sup>

## Certificates of Insurance

One of the most expensive management lapses of the Port has been the failure to require insurance and verify coverage. Damage to Port facilities by uninsured tenants has had a long and debilitating effect on Port assets and cash flows. The 2011 audit found:

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

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<sup>16</sup> Internal Audit of Port of Richmond, Kevin W. Harper CPA & Associates, June 28, 2011, 19

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.

An expensive recent incident involves the sinking of the Tug Tiger, a decommissioned 205-foot former Navy tug, which sank while moored at the former dry dock in the Port of Richmond, December 11. The owners of the vessel had no insurance and no assets, and the port will be stuck with both the legal and operational costs of moving the vessel.<sup>17</sup>

## Goals and Operating Statistics

Although the Port develops objectives, strategic goals, supporting actions and success indicators as part of the budget process each year, many of the success indicators are simply processes and not performances. The 2011 audit found:

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

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<sup>17</sup> <https://www.piersystem.com/go/doc/823/1263939/>, <http://www.d11.uscgnews.com/go/doc/823/1263935/>, <http://www.baycitizen.org/san-francisco-bay/story/sunken-tug-stumps-coast-guard-richmond/>

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.

## 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)

## Operating Procedures

The 2011 audit found that the Port lacked written standard operating procedures and that the lack thereof had resulted in monetary losses and unnecessary risk exposure.

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.

## **The Honda Port of Entry Project**

The Honda port of Entry project was intended to provide the infrastructure required to enter into a long-term lease for the importation of Honda automobile. The total expenditure as of November 2011 was \$38,860,100. Only \$22,349,232 of that was actually spent on Port property. The remainder was spend upgrading rail infrastructure on BNSF property or within BNSF rail right of way, a sweet deal for BNSF.

## **Terminal 4**

It is a mystery why Terminal 4 is still assigned to the Port. The property consists of 37 acres that has not been used for port purposes for years and has long since been removed from Port Priority designation in the San Francisco Bay Plan. It is rented to Pio’s Trucking for \$20,250 a year and is used for nothing but storage.

## **Security Projects**



Despite \$14 million in security grants, almost nothing is working. The \$3 million surveillance system is non-functional.

## Conclusion

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."<sup>18</sup>

The public Port business in northern California is both marginal and highly competitive. The use of all of the active Port properties is restricted to Port-related uses by the San Francisco Bay Plan. The Port's strategic Plan and Mission have to be carried out within those constraints.

Competition and the use constraints drive the cost of imports down and make Port operators subsidizers of cheap imports for the ultimate consumers.

The Port of Richmond's principal activity involves the importation of automobiles from Japan, and while that activity certainly generates some jobs, consider how many more jobs would be generated if those vehicles were built in the United States. As a money losing operation, the Port of Richmond ironically is subsidizing the importation cost of Japanese-made cars and making them more competitive with American-made cars. Is this the best use to which our Port can be put?

Fiscally, the Port measures its success not by profitability but by gross revenue and throughput – and sometimes by job creation. Perhaps this is the best our Port can do under the circumstances, except that due to gross mismanagement, the Port is not even maximizing its opportunities in any case.

The Port of Richmond needs to be reorganized into an efficient and competent property management organization that maximizes opportunities to fulfill its strategic plan and mission. The current management team has proven that they do not have that capability, and they should be replaced.

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<sup>18</sup> Internal Audit of Port of Richmond, Kevin W. Harper CPA & Associates, June 28, 2011, 13