



AUDIT COMMITTEE

Report to the
Board of Harbor Commissioners

"FOR INFORMATION ONLY"

DATE: JANUARY 18, 2022

TO: BOARD OF HARBOR COMMISSIONERS

**SUBJECT: ACTION PLAN ON RESULTS OF PERFORMANCE
AUDIT OF OPERATING AGREEMENT 13-3112 WITH
PORTS AMERICA CRUISE, INC.**

There were three key findings and six audit recommendations on the Performance Audit of Operating Agreement 13-3112 between the City of Los Angeles Harbor Department and Ports America Cruise, Inc. (Ports America).

The attached chart shows Waterfront & Commercial Real Estate Division's (WCRED) planned course of action on these three key findings:

AUDIT FINDING	AUDIT RECOMMENDATIONS	PLANNED COURSE OF ACTION
1. Ports America Did Not Remit Trash & Sweeper Vessel Charge Fees as Required	A. Invoice Ports America for all underpaid trash and sweeper fees allowable under the Operating Agreement, estimated in this report to be approximately \$390,000 for the five-year period July 1, 2015, through June 30, 2020.	1. Auditor to compare and extrapolate data from Ports America's data submission for trash and sweeper vessel charges from January 2016 to January 2021. 2. Auditor to provide POLA with a total estimate of vessel charge fees from these categories that Ports America did not remit to POLA from 2016-2021. 3. POLA intends to require Ports America to remit 100 percent of these vessel charge because they were expressly referenced in Operating Agreement Exhibit J-1 as items requiring 100 percent remittance.

	<p>B. Implement processes to improve the accuracy of trash and sweeper fee remittances to POLA, including requiring Ports America to base estimated payments (if any) to be based on actual prior year charges to cruise lines, and that actual remittances to POLA are reconciled to actual billings to cruise lines on a periodic basis to ensure that Ports America pays 100 percent of all vessel charge fees to POLA as required in the Operating Agreement.</p>	<p>1. Waterfront and Commercial Real Estate Division (WCRED) will negotiate revised operating agreement that will expressly and clearly delineate which vessel charges require Ports America to pay 100 percent of all vessel fees to POLA and which vessel charges items allow for Ports America to retain some portion of vessel charges remitted by cruise lines.</p>
<p>2. Ports America Did Not Report or Remit any Revenues Collected for Gangway or Security Services, As Required in the Operating Agreement</p>	<p>C. Require Ports America to report all revenues generated for gangway services and security services, pursuant to the Operating Agreement, and invoice Ports America for all of the fees collected.</p>	<p>1. Auditor to compare and extrapolate data from Ports America’s data submission for gangway vessel charges from January 2016 to January 2021.</p> <p>2. Auditor to provide POLA with a total estimate of gangway vessel charge fees from this category that Ports America did not remit to POLA from 2016-2021.</p> <p>3. POLA intends to not require Ports America to remit 100 percent of gangway vessel charge fees because this item was not expressly referenced in Operating Agreement Exhibit J-1 as an item requiring 100 percent remittance.</p> <p>4. WCRED disagrees with the audit finding regarding out of scope Security Services and agrees that Ports America complied with Section 3(D) of the Agreement that Ports America to provide 2 security guards on non-ship days, 24/7 and Section 3(E) of the Agreement that Ports America can provide additional security at the request of the cruise line, under a separate arrangement.</p>

<p>3. POLA and Ports America Miscalculated the Annual Management Fee due to utilization of the wrong CPI escalation and inclusion of a Tax and Insurance escalation on ILWU labor rates resulting in Overpayments of Nearly \$80,000 Over Five Years</p>	<p>D. Invoice Ports America for \$79,755.16 in overpaid management fees for July 2015 - June 2020.</p>	<ol style="list-style-type: none"> 1. Ports America agreed to reconcile past management fee charges with the correct CPI which would result in remittance of miscalculated management fees back to POLA. 2. POLA Management agreed to include the escalation for Taxes & Insurance on ILWU Labor as the agreement intends these labor costs to be a pure pass through in which including of applicable taxes and insurance would be reasonable. 3. Auditor to compare & extrapolate data from Ports America's data submission, back-up documentation and market comparables provided on Taxes & Insurance to determine a reasonable escalation for rate for this item from Jan 2016 to Jan 2021 (5 years). 4. Auditor to compare data collected from item 3 above and compare with amount that Ports America charges other clients as well as market rates to determine and also market rate that other similar providers as Ports America. Auditor will provide POLA with the current management fee and overflow facilities fees.
	<p>E. Implement improved internal controls and review procedures relating to Ports America's submittal of required reports (Forms J-1 and J-2) and fee remittances. This should include a review of Ports America's cruise line billings to ensure it remits 100 percent of all fees collected to POLA, and reconciling reported and remitted amounts to source documentation such as passenger manifests and Ports America's billings to cruise lines.</p>	<ol style="list-style-type: none"> 1. . WCRED will negotiate a revised operating agreement that will expressly and clearly delineate which vessel charges require Ports America to pay 100 percent of all vessel fees to POLA and which vessel charges items allow for Ports America to retain some portion of vessel charges remitted by cruise lines.
	<p>F. Ensure POLA's and Ports America's calculations of management fee escalation rates remain consistent with the provisions set forth in the Operating Agreement.</p>	<ol style="list-style-type: none"> 1. WCRED will work closely with Ports America to ensure the correct annual CPI factor is utilized along with an agreed to escalator for taxes and insurance in the annual calculation of the management fee.

Michael DiBernardo

MICHAEL DiBERNARDO
Deputy Executive Director

Transmittals:

1. Performance Audit of Operating Agreement 13-3112 with Ports America
2. Follow-Up Memorandum of POLA's Performance Audit of Operating Agreement 13-3112

MD:MG:HP:VD:raw

Author: V. Dorfman

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Port of Los Angeles

Performance Audit of Operating Agreement 13-3112 with Ports America

May 2021



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RESULTS

Ports America provided the services required under the Operating Agreement, including terminal operations and maintenance, vessel scheduling, terminal security, reporting, and administrative services. However, it underpaid certain vessel charge fees, including fees charged to cruise operators for trash, sweeper, gangway, and security services. This audit estimates that Ports America underpaid POLA approximately \$390,000 for trash and sweeper fees between July 2015 and June 2020. Ports America did not provide sufficient documentation of its billings to cruise operators during this audit; as a result, this audit could not estimate amounts owed to POLA for gangway and security services. In addition to these underpayments to POLA, this audit also found that POLA overpaid Ports America's annual management fee by \$79,755 between July 2015 and June 2020.

BACKGROUND AND PURPOSE

In May 2013, the Port of Los Angeles (POLA) executed an Operating Agreement with Ports America, Inc. for the operation, management, and maintenance of POLA's cruise terminal. The original term was five years with the option for two consecutive renewal periods, not to exceed 15 years.

Under this agreement, Ports America is responsible for terminal operations and maintenance; vessel scheduling; terminal security; and administrative services, including annual reporting, billing cruise operators utilizing the cruise terminal a variety of fees, and remitting all fees charged to POLA. The fees charged to cruise operators includes vessel charge fees, Tariff 4 fees, and lay day fees.

In return for providing management services and operating the cruise terminal, POLA compensates Ports America through a flat monthly fee. This fee is escalated annually based on changes in the Consumer Price Index (CPI) and International Longshore and Warehouse Union (ILWU) labor rates.

KEY FINDINGS

This audit presents three findings:

- Ports America did not remit trash and sweeper vessel charge fees as required. The Operating Agreement requires Ports America to remit to POLA 100 percent of all charges to cruise operators for services rendered at the cruise terminal, including charges for water, electricity, gas, sweeper, trash, etc. Our sample of 25 cruise vessels revealed that, on average, Ports America retained 25 percent of all sweeper fees and 33 percent of all trash fees charged to cruise vessels for an estimated underpayment of \$390,000 during the five-year period.
- Ports America did not report or remit any revenues charged to or collected from cruise operators for gangway or security services. The Operating Agreement requires Ports America to provide gangway and security services. Ports America charged cruise operators for providing these gangway and security services. However, instead of remitting 100 percent of the gangway or security vessel charge fees to POLA, Ports America retained them. Ports America asserted that while the Operating Agreement requires it to provide gangway and security services, it was not the intent of the agreement to include revenues from gangway and security services in the agreement's pass-through provisions—all of which require the pass-through of 100 percent of fees charged to cruise lines. Based on this assertion, Ports America refused to provide information relating to the amounts charged for this audit.
- POLA and Ports America miscalculated the annual management fee, resulting in overpayments of \$79,755 to Ports America between 2015 and 2020. The miscalculation was the result of applying the incorrect CPI factor, including unallowable expense factors in the ILWU-based escalation calculation, and applying inconsistent rounding in the monthly fee calculations.

KEY RECOMMENDATIONS

- Invoice Ports America for underpaid trash and sweeper fees, estimated to be \$390,000 for the five-year period, and implement processes to improve the accuracy of trash and sweeper fee remittances in the future.
- Require Ports America to report revenues generated for gangway security services, and invoice Ports America accordingly.
- Invoice Ports America for \$79,755.16 in overpaid management fees, and ensure future calculations remain consistent with the provisions set forth in the Operating Agreement.
- Implement review procedures relating to Ports America's submittal of required revenue reports and fee remittances sufficient to identify instances in which Ports America fails to remit 100 percent of required fees.

Introduction and Background

For decades, the Port of Los Angeles (POLA) has outsourced the operation of its cruise terminal. Most recently, on April 26, 2012, POLA released a Request for Proposals (RFP) and received two proposals in response. On May 7, 2013, the Los Angeles City Council adopted a resolution approving an Operating Agreement (13-3312) with Ports America, Inc. (Ports America) for the operation, management, and maintenance of the cruise terminal. The original agreement term was five years with the option for two consecutive renewal periods of five years each, for a total agreement term not to exceed 15 years. Prior to 2013, the Cruise Terminal was managed by Pacific Cruise Ship Terminals, a subsidiary of Metro Port Services, for ten years.

In 2013, the volume of cruise ship passengers had been declining over the previous three years from over 800,000 in 2010 to 355,000 in 2013. Volume began recovering the following year and has held somewhat steady through 2019, in which POLA reported that 110 cruise vessels visited the Los Angeles World Cruise Center, including more than 500,000 passengers.

Overview of the Cruise Terminal Operating Agreement

POLA's Waterfront / Commercial Real Estate Division (WCRED) is responsible for managing the cruise terminal property and administers POLA's Operating Agreement with Ports America. Under this agreement, Ports America is responsible for facilities management, vessel scheduling, terminal security, and administrative services. Specifically, Ports America is responsible to:

- **Terminal Operations and Maintenance:** Oversee Terminal operations, including berthing, embarkation and debarkation of passengers and goods; manage and operate gangways, elevators, and escalators used for passenger embarkation or debarkation; provide janitorial and routine maintenance such as vacuuming, dusting, window washing, removal of bird droppings, trash disposal; and maintain audio-visual equipment used by the cruise lines.
- **Vessel Scheduling:** Develop, maintain, and update quarterly a comprehensive schedule of vessel arrivals and departures and submit to POLA for approval.
- **Terminal Security:** Maintain compliance with the approved Facility Security Plan; provide trained, competent, and efficient security guards on the Cruise Terminal on a 24-hour basis; and provide security screening equipment for customs and baggage inspection checkpoints.
- **Reporting:** Prepare and provide annual written reports on the progress and status of Cruise Terminal Operations.
- **Administrative Services:** Collect applicable fees from cruise lines and remit to POLA. The Cruise Terminal is fundamentally a revenue-generating operation, and a core responsibility of Ports America under the Operating Agreement is the collection of fees from cruise lines and the remittance of receipts to POLA. This includes all charges accruing at the cruise terminal pursuant to POLA's Tariff

4, all applicable vessel charge fees, and all lay day fees; Ports America must remit 100 percent of such fees to POLA within thirty (30) calendar days after the vessel departure. Specifically:

- **Vessel Charge Fees:** Upon docking at the cruise terminal, during the embarkation and debarkation of passengers and goods, and vessel departure, vessels utilize POLA resources and are required to compensate POLA for the use of its terminal. This includes, but is not limited to, utility costs, such as water, electricity, and gas; trash disposal and sweeper services; and other related services. Charges for such costs are referred to as “vessel charge fees.” The Operating Agreement between POLA and Ports America requires Ports America to remit to POLA 100 percent of all vessel charge fees,¹ and to report all such fees charged to cruise vessels on a standardized report (Form J-1) of all such charges collected from cruise lines and remitted to POLA.² When Ports America submits Form J-1 reports, POLA’s Accounting Unit retroactively creates an invoice for each of the charges.
- **Tariff 4 Fees:** Pursuant to Tariff 4, the Operating Agreement requires Ports America to collect from cruise lines, for each vessel berthed at the terminal, passenger fees, wharfage, dockage, and all other applicable Tariff 4 fees. Ports America is required to remit 100 percent of all Tariff 4 Fees collected from cruise vessels to POLA, and must report all such fees charged to cruise vessels on a standardized report (Form J-2). POLA’s wharfingers, located in the Cargo / Industrial Real Estate Division, are responsible to track vessels docking and departing the terminal, compile monthly statistics of vessels, and send invoices to Ports America for the Tariff 4 fees from the cruise companies.
- **Lay Day Fees:** If a vessel remains in port for 24 hours or less, Tariff 4 and vessel charge fees are sufficient to cover the cost of dockage. However, if a vessel remains berthed for more than 24 hours, whether due to scheduling or vessel maintenance, Ports America must charge the cruise line an additional “Lay Day Fee.” The Operating Agreement requires Ports America to collect and remit all Lay Day Fees to POLA, and to report Lay Day Fees on Form J-1. Vessel docking and scheduling is tracked by POLA’s wharfingers.

In addition to requiring that Ports America remit to POLA all charges accruing at the cruise terminal pursuant to Tariff 4, all applicable vessel charge fees, and all Lay Day Fees within thirty (30) calendar days after the vessel departure, the Operating Agreement also includes a catch-all provision, requiring Ports America to remit to POLA 100 percent of gross revenues from every business activity conducted at the cruise terminal.³

In return for providing management services and operating the cruise terminal, POLA compensates Ports America through a flat monthly fee. This differs from the former Operating Agreement, under which the prior terminal operator was compensated through the collection of fees from cruise lines. The rationale for changing the compensation structure was to implement a more cost-effective approach to managing the cruise terminal that would provide increased transparency and accountability of revenue and collections of

¹ Operating Agreement Exhibit B, Section 4(C)

² Operating Agreement Exhibit B, Section 4(E)

³ Operating Agreement Exhibit B, Section 4(L)

all Tariff charges and other associated costs and fees for the cruise terminal. Per the current Operating Agreement, Ports America is not to receive any compensation as a result of the collection of Tariff 4, vessel charge fees, or Lay Day Fees. Instead, 100 percent of all fees collected from cruise lines, and all revenue from every business activity at the cruise terminal, is to be remitted to POLA. The Operating Agreement set forth the following compensation provisions for Ports America:

- A flat management fee originally set at \$125,000 per month, or \$1.5 million annually. The monthly management fee is a fixed fee paid by POLA to Ports America as an all-inclusive fee for all expenses that Ports America incurs during its operation of POLA's Cruise Terminal in fulfillment of the Operating Agreement's Scope of Work.
- In addition, compensation is paid to the operator for overflow facilities, as needed, when there are three or more ships calling at the port on any single day. The Operating Agreement capped compensation for the management of overflow facilities at \$75,000 per occurrence; Amendment 1 increased this cap to \$150,000 in 2014.

Both the monthly fee and overflow compensation are adjusted upwards each year in accordance with escalation rates based on the Consumer Price Index and International Longshore and Warehouse Union (ILWU) labor rates. As of April 2020, the monthly fee was \$143,517, or \$1.7 million annually, and the overflow compensation was not to exceed \$166,363 per occurrence. WCRED is responsible for facilitating communication between Ports America and POLA, and processing Ports America's monthly management fee as well as reimbursements for Overflow days.

Scope and Methodology

Sjoberg Evashenk Consulting, Inc., was engaged by the City of Los Angeles' Harbor Department, or Port of Los Angeles (POLA), to conduct a performance audit of POLA's cruise ship terminal operations. The scope of this audit includes the operator's financial reporting and compliance with the terms and conditions of Operating Agreement 13-3112 for the years 2015–2019 (audit period). The purpose of this independent performance audit was to assess Ports America's overall compliance with the terms and conditions of the agreement, including determining (a) Ports America's compliance with the terms and conditions of the agreement; (b) whether the amounts reported by Ports America were complete and accurate and that their records support their financial statements; (c) whether Ports America maintained adequate supporting documentation; and (d) Ports America's ability to adhere to budgeted expenditure targets.

To meet the audit objectives, we performed the following audit procedures:

- Reviewed Operating Agreement 13-3112 between Ports America, Inc. and the Port of Los Angeles; identified all services Ports America is obligated to perform under the Operating Agreement, including the collection and remittance of revenues from cruise lines, and compensation owed to Ports America in return for such services.
- Conducted interviews with management and key representatives of Ports America and POLA, including POLA's Waterfront / Commercial Real Estate Division (WCRED), POLA's wharfinger's in the Cargo / Industrial Real Estate Division, and POLA's Accounting Unit within its Finance & Administration Division. Identified the roles and responsibilities of key personnel and POLA divisions with respect the management and oversight of the Operating Agreement.
- Evaluated financial and other records of POLA and Ports America to determine whether financial transactions and compensation were consistent with obligations as set forth in the Operating Agreement. We obtained and analyzed POLA financial records relating to payments issued to Ports America, particularly focusing on monthly management fee payments, invoices issued to Ports America, and payments received from Ports America. Similarly, we obtained and analyzed Ports America's vessel schedules and financial records, including Ports America's accounts receivable reports showing billings to cruise lines and remittance reports reflecting payments issued to POLA. We identified revenue streams and related business activity reflected in the fiscal records.
- Selected a sample of 25 vessels between July 1, 2017, through June 30, 2020, and analyzed Ports America's billings to the cruise lines and remittances to POLA to identify all charges for services performed within the scope of the Operating Agreement. We examined all revenue and expense types for compliance, accuracy, and supportability, and determined whether Ports America remitted all required revenues to POLA, as required in the Operating Agreement.
- Obtained and reviewed worksheets used by Ports American and POLA to calculate management fee escalation rates, as well as fiscal records provided by Ports American and POLA showing management fee payments remitted by POLA to Ports America, and determined the actual paid by

POLA to Ports America in management fees for the five contract years between July 2015 and June 2020. We independently calculated the escalation rates based on the methodology prescribed by the Operating Agreement—which applies rate increases based on the Consumer Price Index (CPI) and International Longshore and Warehouse Union (ILWU) labor rate changes—and compared our results to the rates applied by POLA to determine if POLA appropriately compensated Ports America.

Audit fieldwork was performed between July 2020 and January 2021. On April 27, 2021, a draft of this report was provided to Ports America management for review and discussion. POLA's WCRED generally agreed with the findings and recommendations of this report, and Ports America generally disagreed with the findings and recommendations of this report. Responses and feedback provided were considered and incorporated where applicable in the final report. Ports America submitted a written response to this audit report, which will be transmitted concurrently with this audit report to the Audit Committee of the Board of Harbor Commissioners.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide 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.

Audit Findings

Overall, this audit found no evidence that Ports America failed to provide the services for which it was obligated to provide under the Operating Agreement, including terminal operations and maintenance, vessel scheduling, terminal security, reporting, and administrative services. It did find, however, that Ports America underpaid fees due to POLA and that POLA overpaid the management fees due Ports America.

In most cases, Ports America collected and remitted Tariff 4 and vessel charge fees as required, submitted complete and accurate records of fees collected and remitted, and maintained adequate supporting documentation. However, we found four types of vessel charge fees collected by Ports America for which they did not fully report or remit monies collected from cruise lines. Each fee related to a service provided pursuant to the Operating Agreement's Scope of Work. Exhibit 1 lists the different types of fees Ports America charged to cruise lines and whether Ports America reported and remitted the full amounts to POLA.

EXHIBIT 1. TARIFF 4 AND VESSEL CHARGE FEES COLLECTED AND REMITTED

Service Charged to Cruise Lines	Reported and Remitted to POLA		
	Yes	No	N/A
Audio-Visual Expenses	✓		
Berth 46 Charges	✓		
Dockage	✓		
Fleet Week			✓
Fresh Water	✓		
Gangway Services		x	
Lay-Day Fee	✓		
Non-Standard Services			✓
Passenger Fees (Tariff 4)	✓		
Passenger Fees (PMA)			✓
Sanitation Services			✓
Security Guard			✓
Security: Passenger Screening & Equipment		x	
Shore Power	✓		
Stevedore Services			✓
Sweeper		Partial	
Trash/Garbage Containers		Partial	
Wharfage	✓		

Source: Ports America's accounts receivable reports showing all services for which it invoiced cruise lines.

As shown in Exhibit 1, Ports America underreported and underpaid two types of vessel charges fees collected from cruise lines—those related to trash and sweeper fees (shown as “partial” in the chart above). In total, Ports America underpaid POLA approximately \$390,000 for the five-year period between July 2015 and June 2020. Exhibit 1 also shows that Ports America did not report or remit any fees collected from cruise lines relating to two other service categories, security and gangway services, as required under the Operating Agreement. Ports America argued that gangway and security services were not performed as part of the scope of work under the Operating Agreement, and refused to provide financial information related to those services. As a result, the magnitude of Ports America’s underreporting and remittances could not be determined exactly. Finally, our audit also revealed that POLA overpaid monthly management fees by \$79,755.16 between July 2015 and June 2020. The following three findings discuss these problems.

Ports America Did Not Remit Trash & Sweeper Vessel Charge Fees as Required

The Operating Agreement requires Ports America to remit to POLA 100 percent of all “vessel charge fees,”⁴ which include charges to cruise lines for water, electricity, gas, sweeper, trash, and other related services, and to submit a report (Forms J-1 and J-2) of all such charges remitted to POLA.⁵ For all of the 25 vessels sampled, Ports America charged cruise lines more than it remitted to POLA. Specifically, for trash and sweeper fees, Ports America only remitted to POLA between 60 and 77 percent of the fees it billed to cruise lines. In one example, Ports America collected \$900 from a cruise line for trash services, which included a \$575 base fee and \$325 markup. We found Ports America only remitted the base fee to POLA and retained 36 percent of the \$900 that Ports America billed the cruise line.

Our analysis revealed that Ports America consistently retained between 23 and 34 percent of Sweeper fees and between 25 and 40 percent of Trash fees. Assuming these mark-ups remained constant over the full period, the total amounts retained by Ports America would have been no less than \$332,000 and no more than \$503,000. However, our sample of 25 cruise vessels revealed that these minimum and maximum withholding percentages were atypical. Rather, on average, Ports America routinely retained approximately 25 percent of all Sweeper Fees and 33 percent of all Trash Fees charged to cruise vessels. Assuming Ports America’s practice remained consistent over the five-year period, we estimate that it underpaid approximately \$390,000.

Ports America explained that it retained these amounts as a mark-up charged to cruise lines, in part, in order to compensate for administrative costs. It also stated that the apparent retention of sweeper and trash fees was in fact Ports America’s attempt to estimate fees in order to report them to POLA before the fees were actually charged to cruise lines; the difference was simply never tried-up or reconciled at a later date. In considering both of these explanations, we concluded that:

- By requiring Ports America to remit to POLA 100 percent of all vessel charge fees charged to cruise lines, the Operating Agreement does not allow Ports America to retain any mark-up on vessel charge fees. As noted above, Ports America management stated that the mark-ups were charged to cruise lines in order to compensate for administrative costs. However, the Operating Agreement stipulates that Ports

⁴ Operating Agreement Exhibit B, Section 4(C)

⁵ Operating Agreement Exhibit B, Section 4(E); and Exhibit J

America shall furnish all services, materials, equipment, subsistence, transportation and all other items necessary to perform the Scope of Work at the operator's sole cost and expense.⁶ POLA compensates Ports America for administrative costs through the monthly management fee.

- If the amounts remitted to POLA were intended to be an estimate, compliance with the contract would require a true-up or reconciliation process post-remittance to ensure that 100 percent of all amounts charged to cruise lines were remitted to POLA. Further if the variance between charges and remittances was indeed the result of Ports America estimating trash and sweeper charges, we find that the basis for the estimation requires updating. A reasonable estimate of trash and sweeper fees per vessel would be based on similar vessels with similar passenger counts during the preceding year. Therefore, we recommend that, to the extent estimates are used to pay POLA prior to a reconciliation or true-up process, the estimates should be based on actual prior year charges to cruise lines.

While Ports America was required to report and remit 100 percent of all charges related to trash and sweeper services, POLA was not aware that Ports America had not complied with this requirement because POLA staff rely solely on the information reported to it by Ports America on the Exhibit J forms (Forms J-1 and J-2). To make the actual transfer of money, Ports America remits periodic ACH payments that include the remittance of Tariff 4 and vessel charge fees associated with numerous vessels. POLA reconciles the total amount of the ACH payment against the amounts reported on the Forms J-1 and J-2 for each vessel. In effect, POLA's process relies on comparing amounts reported by Ports America to amounts remitted by Ports America; it does not rely on actual source documentation. For Tariff 4 fees, which are based on per-passenger counts, source documentation against which Ports America's reported and remitted fees could be reliably reconciled should include passenger manifests from the cruise line. For vessel charge fees, for which Ports America must report and remit 100 percent of the fees collected from cruise lines, source documentation against which Ports America's reported and remitted fees could be reliably reconciled should include Ports America's actual billings to cruise lines. By comparing amounts reported by Ports America to amounts remitted by Ports America, POLA lacks the ability to detect under-reported and underpaid amounts.

Ports America Did Not Report or Remit any Revenues Collected for Gangway or Security Services, As Required in the Operating Agreement

Among a variety of other service required of Ports America in the Operating Agreement, the Scope of Work requires Ports America to perform specific gangway services and security services. According to the agreement, Ports America is fully responsible to carry out all services described in the Scope of Work, and to do so at its sole cost,⁷ including charging cruise lines fees associated with services rendered by Ports America and remitting those fees to POLA. In return, the Operating Agreement provides remuneration in the form of a flat management fee to be paid monthly by POLA to Ports America.

Gangway services and security services are explicitly required in the Scope of Work. Ports America performs all required gangway and security services, and Ports America charges cruise lines for such services. Yet, Ports America asserts that such services are not included in the Scope of Work, that the management fee

⁶ Operating Agreement Section 1(B)

⁷ Operating Agreement Section 1(B)

does not compensate Ports America to provide such services, and that it cannot provide such services at its sole cost. Rather, Ports America asserts that it must charge cruise lines directly for gangway and security services and is not required to remit *any* of the fees collected to POLA. Below, we describe the contractual requirements associated with both gangway services and security services, and our finding that both indeed fall within the scope of the Operating Agreement and are subject to provisions requiring Ports America to remit all fees collected to POLA.

Gangway Services

The Operating Agreement requires Ports America to manage the operation of the City-owned passenger gangways—the equipment used to help passengers embark and disembark a cruise vessel—at the Cruise Terminal.⁸ According to the Operating Agreement, this involves fueling and positioning the gangway. According to Ports America, managing the operation of the gangway also requires monitoring the gangway throughout the day and removing the gangway when the vessel departs. Ports America charged cruise lines for gangway services and did not remit those charges to POLA.

Ports America management believes the cost of providing gangway services, specifically its subcontract with an electrician, is not covered by the management fee and provided two reasons why it believes that it is fully within its rights to bill the cruise lines directly for such services and to retain the full proceeds from such billings.

- First, Ports America asserts that it is only required to report charges to cruise lines that are specifically listed in Exhibit J of the Operating Agreement, which provides templates for Ports America to use when remitted cruise terminal revenue. Specifically, as described earlier, Form J-1 is used to report vessel charge fees, including but not limited to trash, sweeper, water, and “other.” According to Ports America, because J-1 does not explicitly include a line item for gangway services, Ports America management believes that they are not required to submit any revenue derived from its role in managing the operation of the gangway. Upon review, we do not agree with Ports America’s assertion. The list of potential fees included in Form J-1, which required the reporting of vessel charge fees, was never intended to be all-inclusive. The Operating Agreement explicitly states that Ports America shall remit 100 percent of vessel charge fees including “but not limited to” sewer, gas, electricity,⁹ and Form J-1 includes an “other” category that is clearly intended to capture other charges to cruise lines for services performed pursuant to and within the Scope of Work of the Operating Agreement.
- Second, according to Ports America, the nature of gangway operations—the cost of which depends entirely on the scheduling of vessels in port—make it impossible to accurately estimate the annual cost of gangway operations as part of the management fee. While, it may be true that actual costs depend on vessel scheduling, the same is true of all other

⁸ Operating Agreement Exhibit B, Section 1(B); Exhibit B, Section 2(C); Exhibit B, Maintenance and Repair Responsibilities, Operator Responsibilities

⁹ Operating Agreement Exhibit B, Section 4(C)

vessel charge fees for which POLA or Ports America incurs costs based on vessels in port. Such costs depend on an uncertain and unpredictable vessel schedule, and include trash, sweeper, water, sewer, electricity, and other costs. The Operating Agreement requires the passthrough of a variety of fees charged to cruise lines to pay for costs incurred in executing the services described in the Scope of Work, and the agreement does not exclude charges relating to managing the operations of the gangway from the reporting and remittance of vessel charge fees.

Based on these two assertions, Ports America declined to provide any information relating to the actual amounts charged to cruise lines for gangway services, whether on a per-vessel basis or in aggregate. We do not agree with Ports America's assertion that such charges are out-of-scope, and therefore find that, by declining to provide evidence of the amounts charged to cruise lines for gangway services, Ports America is in violation of the Operating Agreement's provision allowing POLA access to all relevant financial records associated with the execution of the Scope of Work. Specifically, the Operating Agreement states:

[Ports America] shall keep and maintain full, complete and accurate books of accounts and records of the services performed under this Agreement in accordance with generally accepted accounting principles consistently applied, which books and records shall be readily accessible to and open for inspection and copying at the premises by City, its auditors or other authorized representatives.¹⁰

Without this information, neither we nor POLA can determine the magnitude of withheld revenues.

Security Services

The Scope of Work requires Ports America to manage terminal security,¹¹ which explicitly includes:

- a) Maintaining compliance with the federally required Facility Security Plan (FSP),¹² which includes security administration and organization of the facility, security systems, and equipment maintenance; and security measures for handling cargo;
- b) Securing the cruise terminal in compliance with 33 CFR 105.100 *et seq.*¹³ CFR requires the facility owner or operator to "screen persons, baggage (including carry-on items), personal effects, and vehicles, for dangerous substances and devices at the rate specified in the approved FSP."¹⁴
- c) Providing sufficient functioning security screening equipment, such as x-ray machines, magnetometers, and explosive detectors, to screen all passengers, crews, visitors, and baggage at the Terminal;¹⁵

¹⁰ Operating Agreement Section VIII(A)

¹¹ Operating Agreement Exhibit B, Section 1(B)

¹² Operating Agreement Exhibit B, Section 3(C)

¹³ Operating Agreement Exhibit B, Section 3(A)

¹⁴ 33 CFR 105.255(d)(2)

¹⁵ Operating Agreement Exhibit B, Section 3(G)

- d) Providing sufficient and effective security communications equipment to facilitate all the security operations required at the Terminal.¹⁶
- e) Providing two security guards for the Terminal on a 24-hour basis;¹⁷

Ports America charged cruise lines for “passenger screening” and “security equipment” services, and did not remit revenue from such charges to POLA. According to Ports America, the management fee paid by POLA only covers the cost of providing two security guards for the terminal on a 24-hour basis and, in order to provide all other security services mandated in the Operating Agreement, Ports America billed cruise lines for each cruise vessel in port.

Similar to gangway services, Ports America asserted that it is not required to remit any fees charged to cruise lines that are not explicitly included in Exhibit J of the Operating Agreement, specifically Form J-1. Security services are not listed on Form J-1. However, neither the Operating Agreement nor Form J-1 explicitly excludes charges related to any of the security services described in (a) through (e) above from the same passthrough provisions applied to other services described in the Scope of Work. Rather, as noted previously, the listing of some services on Form J-1 was not intended to exclude other services.

The *only* security-related service explicitly excluded from the Scope of Work relates to what the Operating Agreement refers to as “vessel assigned security.” Specifically, the Operating Agreement states that that Ports America is not responsible for providing vessel-assigned security staff, but may provide such additional vessel-assigned security under separate arrangement with the vessel.¹⁸ While the Operating Agreement does not define “vessel-assigned security,” this provision suggests a level of discretion that is not applicable to the security services described in (a) through (e) above— i.e., that Ports America may or may not provide vessel-assigned security, that cruise lines may or may not request Ports America to provide vessel-assigned security, or that cruise lines may request another party to provide vessel-assigned security. According to Ports America, this provision permitting out-of-scope vessel-assigned security agreements between Ports America and vessel operators does not relate to passenger screening; rather, it was envisioned that Ports America may assign additional security personnel on board vessels or may screen disembarking crew members. Per the Operating Agreement, passenger screening and the provision of screening equipment is a mandatory function of Ports America as the cruise terminal operator.

Based on this assertion, Ports America declined to provide any information relating to the actual amounts charged to cruise lines for security services, whether on a per-vessel basis or in aggregate. We do not agree with Ports America’s assertion that such charges are out-of-scope, and therefore find that, by declining to provide evidence of the amounts charged to cruise lines for gangway services, Ports America is again in violation of the Operating Agreement’s provision allowing POLA access to all relevant financial records associated with the execution of the Scope of Work.¹⁹ Despite

¹⁶ Operating Agreement Exhibit B, Section 3(H)

¹⁷ Operating Agreement Exhibit B, Section 3(D)

¹⁸ Operating Agreement Exhibit B, Section 3(E)

¹⁹ Operating Agreement Section VIII(A)

this, there is evidence to suggest security-related charges could be substantial. In reviewing costs from three-ship days, we noted that Ports America charged POLA \$3,750 for an x-ray machine to screen baggage for a cruise ship's passenger and on the same day it also charged an undisclosed amount to the cruise line for passenger screening for the same vessel. This means that, for three-ship days, Ports America invoices POLA for x-ray machines, presumably because both Ports America and POLA believe the cost of security equipment is POLA's responsibility; POLA compensates Ports America through the agreed-upon management fee. By also charging cruise lines for the same equipment, Ports America is in effect creating an additional vessel charge fee that, consequently, should be remitted to POLA. During the audit period, there were 629 instances of Ports America billing cruise lines for x-ray machines.

Both the Operating Agreement and the original Real Estate Division's staff report recommending approval of the Operating Agreement exclude only stevedoring and guest passenger services from the Scope of Work. We find no basis in the Operating Agreement to conclude that the gangway services or security services actually performed by Ports America are excluded from the Scope of Work. Further, the Operating Agreement only permits Ports America to enter into separate agreements with cruise lines in the event the two parties have agreed that Ports America will provide additional services that are outside the Scope of Work. The Operating Agreement specifically allows Ports America to provide stevedoring and guest passenger services under such separate agreements. It also states, for instance:

[Ports America] may also offer and provide services outside the scope of this Agreement, upon request of passenger vessel operators; such services shall be by separate arrangement between Operator and such vessel operators. If any such services are provided, it does not alter the amount of the Flat Fee ... City pays to the Operator.²⁰

Again, we find no basis to conclude that separate agreements between Ports America and cruise lines for gangway services or security services—as described in this report—meet this criterion. Therefore, we recommend that Ports America immediately report all fees charged to cruise lines for gangway and security services, and remit to POLA 100 percent of fees charged.

In order to estimate the potential revenues gangway and security services generated through cruise line billings, we contacted three peer ports—the ports of San Francisco, Seattle, and San Diego. Each operates their cruise terminals in a manner different than POLA. For instance:

- The Port of San Francisco contracts with its cruise terminal operator, which pays the Port a flat fee for the exclusive right to operate the cruise terminal and to provide stevedoring services. Under this model, the Port of San Francisco bills cruise lines directly for tariff and dockage fees—retaining all those revenues—and, in return for paying a flat fee to the ports, the cruise terminal operator charges cruise lines for stevedoring, passenger screening, and gangway services—retaining all revenues received. As described previously, this differs from the status quo between POLA and Ports America. In both scenarios, the ports retain all tariff and dockage fees and the operators retain all stevedoring, security, and gangway fees; yet, the Port of San Francisco requires the operator to pay them a flat

²⁰ Operating Agreement Exhibit B Section 1(A)

fee for the exclusive right to provide stevedoring, security, and gangway services, while POLA pays Ports America a flat fee.

- The Port of Seattle leases the cruise terminal to an independent operator, which pays rent through revenue-sharing of port-directed cruise fees (tariff and dockage fees). Like the Port of San Francisco, the terminal operator bills security fees to cruise lines, retaining all proceeds; unlike the Port of San Francisco, the Port of Seattle utilizes an independent stevedoring firm, which bills stevedoring and gangway services to cruise lines. Again, this differs from the status quo between POLA and Ports America. While neither the Port of Seattle nor POLA retain any stevedoring, security or gangway charges, the method of compensating the operator differs; POLA pays its operator a flat fee and the Port of Seattle allows its operator to retain a percentage of tariff and dockage fees.
- The Port of San Diego, unlike the ports of San Francisco and Seattle, operates the terminal through in-house staff or directly outsourced labor, such as a contract with a security contractor. The Port of San Diego charges cruise lines an average of \$14,600 per vessel for passenger screening; it does not charge for gangway services. This again differs from POLA's status quo arrangement with Ports America, in which the Port of San Diego bills for all tariff, dockage, and security fees, and retains all proceeds to cover operating costs and to operate as a successful enterprise. At roughly 110 cruise vessels per year, this would amount to over \$1.6 million per year.

As mentioned previously, POLA had previously contracted with a cruise terminal operator through an arrangement similar to that of the ports of Seattle and San Francisco, in which the terminal operator was compensated through proceeds retained from cruise terminal billings (tariff, dockage, security, and other fees). POLA moved away from this model in its current operating agreement, with the express intent to implement a more cost-effective approach to managing the cruise terminal while also providing increased transparency and accountability of revenue and collections of all Tariff charges and other associated costs and fees for the cruise terminal. Existing practice appears more closely aligned with POLA's prior operating agreement—and with peers which have adopted similar models—than with its current agreement and the intent it was designed to achieve.

POLA and Ports America Miscalculated the Annual Management Fee, Resulting in Overpayments of Nearly \$80,000 Over Five Years

To evaluate the annual increase of the management fee, including determining whether the methods employed to calculate fee increases complied with contractual requirements, we analyzed the worksheets used to calculate the escalation rates and reviewed accounting records for both POLA and Ports America to determine the actual amounts paid by POLA to Ports America for management fees. Our calculation of the management fee escalation rates—which were based on the explicit methodological approach stipulated in the Operating Agreement—revealed that POLA's calculations produced higher escalation rates than require by the Operating Agreement. As shown in Exhibit 2, POLA paid Ports America \$8,160,647.13 in management fees between July 1, 2015, and June 30, 2020; it should have paid \$8,080,891.97. As a result, POLA overpaid Ports America by \$79,755.16 in management fees during this five-year period.

EXHIBIT 2: MANAGEMENT FEE COMPARISON FOR JULY 2015 THROUGH JUNE 2020

Compensation Period	POLA Accounts Payable Records	Auditor Calculation
July 2015–June 2016	\$1,557,861.12	\$1,546,878.37
July 2016– June 2017	\$1,579,122.41	\$1,562,545.90
July 2017– June 2018	\$1,623,226.78	\$1,602,971.98
July 2018– June 2019	\$1,682,459.82	\$1,661,363.82
July 2019– June 2020	\$1,717,977.00	\$1,707,131.91
Total	\$8,160,647.13	\$8,080,891.97

Source: Auditor-calculation based on ILWU-PMA Labor Agreements and assessment rates, and CPI-W data.

Three factors contributed to POLA’s overpayment of \$79,755.16, including inconsistent and incorrect calculation of the CPI-based escalation rates, the inclusion of certain costs (e.g., tax and insurance) in the ILWU-based escalation rates that were disallowed by the Operating Agreement between Ports America and POLA, and inconsistent rounding of monthly fee payments. Each is described below.

CPI-Based Escalation Rates

POLA and Ports America used the incorrect CPI rate, upon which the management fee escalation calculations were based, in three of four years. As shown in Exhibit 3, POLA twice used the Consumer Price Index for All Urban Consumers (CPI-U) instead of the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W), and once used the correct CPI-W rate for the wrong month—April instead of May. The Operating Agreement requires the escalation be based on the published CPI-W rate for the month of the agreement’s effective date;²¹ the Los Angeles City Council approved the agreement in May of 2013. In two of three years, the CPI-based escalation rate used by POLA was lower than what would have been permitted.

EXHIBIT 3: COMPARISON OF CPI-W RATES FOR MAY OF EACH YEAR AND THE RATE USED BY POLA

Compensation Period ¹	Published CPI-W Rate	CPI Rate Used by POLA	Cause of Discrepancy
May 2016–April 2017	0.63%	0.70%	POLA Used CPI for All Urban Consumers (CPI-U) Instead of CPI-W
May 2017–April 2018	2.43%	2.40%	POLA Used CPI for All Urban Consumers (CPI-U) Instead of CPI-W
May 2018–April 2019	4.27%	4.06%	POLA Applied the CPI-W Rate for April 2018 Rather Than May 2018
May 2019–April 2020	3.36%	3.36%	-

Source: CPI escalation rates as calculated by Ports America for the annual increase of the management fee, and Auditor-calculated CPI rates based on Bureau of Labor Statistics Data.

Note: ¹Neither Ports America nor POLA were able to provide the complete methodology, including CPI escalation rates used, for the management fee calculated for May 2015-April 2016.

²¹ Operating Agreement Exhibit E, Section 1, Footnote

ILWU-Based Escalation Rates

While the majority of Ports America’s management fee is escalated based on the CPI-W rate, a portion of the adjustment is based on changes to the ILWU longshoreman labor rate. Specifically, the Operating Agreement requires sweeper labor costs to be escalated based on the negotiated labor rates “per any applicable collective bargaining agreement or amendment.”²² To calculate the ILWU portion of the management fee adjustment, Ports America measured the increase in three areas: wages, assessment rates, and insurance and taxes. For example, as shown in Exhibit 4, to calculate the labor increase for the May 2019 through April 2020 compensation period, Ports America calculated the total amounts they paid in 2018-2019 for wages, man-hour assessments, and insurance and taxes, and calculated the percent change to 2019-2020 costs. They then divided the difference by the 2018-2019 total for a 1.98% increase for labor rates.

EXHIBIT 4: PORTS AMERICA’S RATE CALCULATION FOR 2019-2020 COMPENSATION PERIOD

	2018-2019 Expenses	2019-2020 Expenses	Change	% Change
Wages	\$42.18	\$43.49	\$1.31	
Insurance & Taxes	\$21.86	\$22.53	\$0.67	
Man-Hour Assessments	\$35.87	\$35.87	\$0.00	
Total	\$99.91	\$101.89	\$1.98	1.98%

Source: ILWU labor escalation rates as calculated by Ports America for the annual increase of the management fee.

Both the wages and the assessment fees are published by the Pacific Maritime Association (PMA), which is the organization that negotiates with the ILWU on behalf of employers, and the rates used by POLA and Ports America were consistent with the rates negotiated in the ILWU’s Memoranda of Understanding. However, also included in this calculation are taxes and insurance costs, such as payroll taxes and workers’ compensation fees; neither can be considered as labor rates negotiated pursuant to any collective bargaining agreements or amendments. To account for this, we recalculated the labor increases for May 2015 through April 2020. As shown in Exhibit 5, Ports America’s labor rate escalation methods inflated management fee increases in each of the four most recent contract years.

²² Operating Agreement Exhibit E, Section 1, Footnote

EXHIBIT 5: AUDITOR-CALCULATED LABOR RATE INCREASES

Compensation Period¹	Ports America Labor Escalation Rate	Auditor Calculated Labor Escalation Rate
May 2016–April 2017	1.65%	1.23%
May 2017–April 2018	3.24%	1.99%
May 2018–April 2019	1.93%	1.63%
May 2019–April 2020	1.98%	1.68%

Source: ILWU labor escalation rates as calculated by Ports America for the annual increase of the management fee, and Auditor-calculated ILWU rates based on ILWU-PMA labor agreements and assessment rates.

Note: ¹Neither Ports America nor POLA were able to provide the complete methodology, including the ILWU labor escalation rates used, for the management fee calculated for May 2015-April 2016.

Inconsistent Rounding

Inconsistent rounding methods also appear in the workbooks used by POLA and Ports America to calculate the monthly management fees. While the actual management fee increases were calculated as a result of the methodology described above, the final result was rounded using inconsistent rounding principles. For example, in one year, \$127,564 was rounded to the nearest thousand (\$128,000), and in the following year, \$131,108 was rounded to the nearest hundred (\$131,100). Subsequently, \$143,514 was rounded to the nearest ten (\$143,510). The net effect of this inconsistency was that fee amounts that were rounded up had a greater impact on the management fee than numbers that were rounded down.

The calculations performed by Ports America and POLA at the beginning of every contract year lacked consistency and compliance with the methods prescribed in the Operating Agreement. In order to ensure compliance with the Operating Agreement, POLA should seek reimbursement of \$79,755.16 in overpaid management fees from Ports America, and should improve upon the consistency of its escalation rate calculations. This should include using only the published CPI-W rate for May of each year, eliminating employer taxes and insurance costs from the labor escalation rate calculation, and limiting rounding of management fee calculations to two decimal places.

Recommendations

In order to ensure POLA both appropriately compensates Ports America for services rendered and receives all revenues due as a result of vessel dockage, as specified in the Operating Agreement, we recommend that POLA:

- a. Invoice Ports America for all underpaid trash and sweeper fees allowable under the Operating Agreement, estimated in this report to be approximately \$390,000 for the five-year period July 1, 2015, through June 30, 2020.
- b. Implement processes to improve the accuracy of trash and sweeper fee remittances to POLA, including requiring Ports America to base estimated payments (if any) to be based on actual prior year charges to cruise lines, and that actual remittances to POLA are reconciled to actual billings to

cruise lines on a periodic basis to ensure that Ports America pays 100 percent of all vessel charge fees to POLA as required in the Operating Agreement.

- c. Require Ports America to report all revenues generated for gangway services and security services, pursuant to the Operating Agreement, and invoice Ports America for all of the fees collected.
- d. Invoice Ports America for \$79,755.16 in overpaid management fees for July 2015 - June 2020.
- e. Implement improved internal controls and review procedures relating to Ports America's submittal of required reports (Forms J-1 and J-2) and fee remittances. This should include a review of Ports America's cruise line billings to ensure it remits 100 percent of all fees collected to POLA, and reconciling reported and remitted amounts to source documentation such as passenger manifests and Ports America's billings to cruise lines.
- f. Ensure POLA's and Ports America's calculations of management fee escalation rates remain consistent with the provisions set forth in the Operating Agreement.

Client Memorandum

To: Michael Galvin, Director of Waterfront & Commercial Real Estate
Port of Los Angeles

From: George Skiles, Partner
Sjoberg Evashenk Consulting, Inc.

Date: January 20, 2022

Subject: **Follow-Up Review of POLA's Performance Audit of Operating Agreement 13-3112**

In June 2020, the City of Los Angeles Harbor Department (Port of Los Angeles, or POLA) engaged Sjoberg Evashenk Consulting, Inc. (SEC) to conduct a performance audit of POLA's cruise ship terminal operations. In May 2021, SEC submitted its final report, which found that POLA had not correctly calculated the management fees paid to Ports America, and that Ports America had not appropriately remitted Trash, Sweeper, and Gangway revenues to POLA.

Background

The May 2021 audit resulted in three findings that, as of November 2021, remained unresolved. Specifically,

- **Ports America did not remit trash and sweeper vessel charge fees.** The audit concluded that Ports America was required to remit 100 percent of trash and sweeper fees charged to cruise lines, but only remitted a portion of those fees. The audit estimated that Ports America did not remit between \$332,000 and \$503,000 in trash and sweeper fees between 2016 and 2020.
- **Ports American did not report or remit any revenues collected for gangway services.** The audit concluded that Ports America was required to remit 100 percent of gangway fees; due to a lack of documentation regarding gangway charges, the audit did not estimate the potential underpayment. Subsequently, it was determined that a portion of the gangway fees charged to cruise lines were passed on directly to a third-party service provider, and POLA agreed that Ports America is not required to remit those fees to POLA.
- **POLA and Ports America miscalculated the annual management fee, resulting in overpayments to Ports America.** The audit concluded that POLA overpaid management fees for three reasons: the inconsistent and incorrect calculation of the CPI-based escalation rates, the inclusion of certain costs (e.g., tax and insurance) in the ILWU-based escalation rates that were not expressly allowed by the operating agreement, and the inconsistent rounding of monthly fee payments. As of November 2021, most factors related to this miscalculation had been corrected, but questions remained regarding the reasonableness of the amount charged by Ports America for tax and insurance component of the ILWU-based escalation rate.

Since May 2021, POLA and Ports America representatives have worked closely and collaboratively to resolve each of these findings. At POLA’s request, Ports America has provided additional accounting records, including detailed transaction records for:

- a) Trash and sweeper fees, showing amounts billed to cruise lines, the percentage of those fees that were actually remitted to POLA and the percentage retained by Ports America.
- b) Gangway charges, showing amounts billed to cruise lines, the percentage of those fees that were actually remitted to POLA and the percentage retained by Ports America.

Ports America also provided additional information relating to its ILWU-based escalation rate calculations.

The objective of this follow-up review was to examine this additional information and to determine the its impact on vessel charge fees owed to POLA and past and current Management Fees.

Underpayment of Vessel Charge Fees

Subsequent to our May 2021 audit report, Ports America provided additional accounting records to POLA in an effort to address under-reported revenues and remittances to POLA. To determine the potential underpayments associated with involving trash, sweeper, and gangway vessel charge fees, we reviewed these records, which calculated an aggregate amount of \$355,065 in retained vessel charge fees between October 2018 and December 2020. This included an assessment of trash and sweeper fees for 257 vessels and gangway fees for 201 vessels. Based on Ports America’s analysis, the average underpayment per vessel for the period between October 2018 and December 2020 was as follows:

POLA AUDIT_TRASH/SWEEPER/GANGWAY SVC (OCT18-DEC20)					
CATEGORY	Billed to Cruise Lines	Remitted to POLA	Variance	Number of Vessels Reported	Average per Vessel
SWEEPER	\$ 568,441	\$ 425,409	\$143,032	257	\$ 557
TRASH	\$ 217,950	\$ 146,551	\$ 71,399	257	\$ 278
GANGWAY	\$ 756,109	\$ 615,475	\$140,633	201	\$ 700
TOTAL EXPOSURE	\$1,542,499	\$ 1,187,435	\$355,065		

The audit scope covered the period between January 2016 and December 2020. However, Ports America could only provide detailed vessel charge fee data for the period October 2018 through December 2020; this date revealed Ports America underpaid POLA over \$355,000 for the two-plus year period. SEC was asked to provide a reasonable estimate of underpayments that occurred between January 2016 and September 2018—the period for which Ports America was unable to provide data—based on underpayment data provided by Ports America for the period between October 2018 and December 2020. To perform this analysis, we determined that Ports America’s practices remained constant throughout the

full five-year period, calculated the average underpayment amount per vessel utilizing the data provided by Ports America, and applied that average to the remainder of the audit period.

According to Ports America's analysis, which was consistent with the results of our May 2021 audit, Ports America underpaid an average of \$557 in sweeper charges, \$278 in trash charges, and \$700 in gangway charges—or a total of \$1,535—per vessel between October 2018 and December 2020.

According to POLA-provided documentation, there were a total of 294 vessels between January 2016 and September 2018. Specifically, there were 118 vessels in 2016, 109 vessels in 2017, and 67 vessels between January and September 2018. Assuming Ports America charged each vessel fees for trash, sweeper, and gangway services, we estimate the total potential underpayments for the period between January 2016 and September 2018 to be as follows:

- Sweeper: \$163,624.11
- Trash: \$81,678.63
- Gangway: \$205,702.70

These potential underpayments are in addition to the variances amounting to \$355,065 reported by Ports America to POLA for the period October 2018 through December 2020, and they do not reflect potential underpayments for the 2021 calendar year.

ILWU Escalation Rate

As noted in the May 2021 performance audit, while the majority of Ports America's management fee is escalated based on the CPI-W rate, a portion of the adjustment is based on changes to the ILWU longshoreman labor rate. Specifically, the operating agreement requires sweeper labor costs to be escalated based on negotiated labor rates. To calculate the ILWU portion of the management fee adjustment, Ports America measured the increase in three areas: wages, assessment rates, and insurance and taxes. Both the wages and the assessment fees are published by the Pacific Maritime Association (PMA), which is the organization that negotiates with the ILWU on behalf of employers, and the rates used by POLA and Ports America were consistent with the rates negotiated in the ILWU's Memoranda of Understanding. However, also included in this calculation are taxes and insurance ("T&I") costs.

While the audit concluded that costs associated with taxes and insurance costs were disallowed from the escalation rate by the operating agreement, POLA agreed that the ILWU portion of the escalation rate was intended to cover all costs borne by Ports America that directly result from the operating agreement's requirement that Ports America utilize ILWU labor. That is, the ILWU-based escalation rates was intended to be a passthrough—a mechanism to pay Ports America monies that would be directly passed-on to other parties (such as employees, the state and federal government, or others). We agree that there are certain costs incurred by Ports America that are a direct result of negotiated compensation increases, such as payroll taxes, and payments to Ports America to cover such costs would pass through to those parties.

According to Ports America, it includes “T&I” as a component of the ILWU escalation rate as a way to recover increased costs associated with payroll taxes and a variety of insurance premiums, including workers’ compensation, property, general liability, and others. Ports America reported utilizing a flat rate of 49.8 percent since the inception of its operating agreement with POLA to recover such costs. For example, if wages increased by \$1.00, Ports America would capture the corresponding increase in costs by applying the T&I rate of 49.8 percent ($\$1.00 + \0.498) to derive an actual increase of \$1.50. Ports America provided examples of contracts it has with other California ports, which include similar rates of 45 percent or 50.7 percent that were applied to labor costs.

SEC was asked to evaluate the reasonableness of this rate. To determine reasonableness, we focused on whether (a) the underlying costs that make up the 49.8 percent rate could be identified and supported, or (b) the costs identified could be considered to be directly attributable to the increased compensation owed to longshoremen and that payment for such costs would pass through to other parties. Based on our analysis, we found that:

- Ports America could not provide any documentation describing how the T&I rate of 49.8 percent was calculated or the cost elements that were included in the rate. Management stated that key components were payroll taxes, which are estimated to be below approximately 14.55 percent, as well as workers’ compensation, property, general liability, and other insurance premiums, but did not provide any documentation substantiating the 49.8 percent rate, the components that made up the rate, or how the rate was calculated.
- With the exception of payroll taxes, Ports America could not demonstrate that the cost elements it identified as constituting the T&I rate were directly attributable to the increased compensation owed to longshoremen and that payments received from POLA to cover such costs would pass through to other parties. Because of this, and because of Ports America’s assertion that T&I is intended to cover a variety of insurance costs—typically considered overhead—it appears that the T&I rate is akin to an indirect cost rate applied to direct labor costs.

While applying an indirect cost rate to direct labor costs may not be uncommon in a variety of circumstances and contexts, we do not believe it is appropriate in this case. Specifically, any portion of the T&I component of the ILWU-based escalation rate that is not passed on to third parties, such as payments to employees or governments for tax purposes, is instead intended to cover Ports America’s indirect operating, administrative, or other business expenses. The Management Fee is already designed to cover the cost of indirect administrative expenses incurred by Ports America, such as insurance costs, and the CPI-based escalation rate is intended to compensate Ports America for increasing administrative and indirect costs associated with the operating agreement.

Furthermore, indirect cost rates are typically prepared by accounting professionals in accordance with accepted accounting principles. Indirect cost rates are generally considered acceptable when they are supported by underlying accounting records, auditable and verifiable, and are confirmed to only include justifiable business expenses.

For these two reasons, unless and until Ports America can produce supporting documentation detailing the costs covered by the 49.8 percent rate, we do not find evidence that a T&I rate any greater than 14.55 percent can be considered to be supported and/or directly attributable to the increased compensation owed to longshoremen under the ILWU negotiated agreement.

Below, we illustrate the difference between the original ILWU escalation rate compared to the revised rates established during the audit and this post-audit review.

ILWU Escalation Rates							
	2015	2016	2017	2018	2019	2020	2021
Original	10.69%	7.55%	1.65%	3.24%	1.93%	1.98%	4.12%
Revised	1.49%	2.64%	1.37%	2.12%	1.73%	1.78%	4.30%

These discrepancies over the years have resulted in an annual management fee that was inflated by more than \$23,000 in Fiscal Year 2020-21. This is detailed in the table below.

Annual Operating Cost Categories	Original 2020-21 Management Fee	Re-Calculated 2020-21 Management Fee
Operational/Administration/SSC	\$398,168	\$398,851
General Janitorial Services	\$255,967	\$256,404
M&R, Consumables	\$56,882	\$56,979
Terminal Security	\$341,289	\$341,873
Insurance	\$153,580	\$153,843
ILWU Mechanical Sweeper	\$382,675	\$359,454
Profit (10%)	\$158,856	\$156,740
Total Management Fee	\$1,747,416	\$1,724,144

Compounded since 2015, inaccurately calculated CPI and ILWU escalation rates resulted in management fee payments to Ports America of \$124,653 that exceeded fees required in the operating agreement.